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ABSTRACT

Part of a series which offers educational resources and teaching techniques related to major social issues to high school social studies classroom teachers, the guide focuses on political and economic aspects of tax policy in the United States. The document is presented in three major chapters. Chapter I explores how economic and political science frameworks can be used to analyze policy issues. Chapter II presents an overview of taxation in the United States. Topics discussed include the role of taxes in United States economy, the nature of tax authority, economic bases for taxation, and criteria used in evaluating the worth of a tax. Chapter III outlines objectives for the tax policy unit, including that students should be able to define and evaluate various kinds of taxes, make informed decisions about reforms, and understand the values involved in tax policies and various tax issues. This chapter also presents instructional activities which involve students in defining terms, identifying and classifying taxes, discussing and analyzing issues in groups and in the class, working problem sheets, and role playing. For each activity, information is presented on recommended use, sequence within the unit, time and materials required, rationale, concepts, instructional objectives, teaching strategies, and pupil activities. (CK)

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Analyzing Tax Policy: A Resource Guide

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1979

Joint Council on Economic Education

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Contents

Foreword iv

Preface vii

INTRODUCTION
LAURENCE E. LEAMER AND PAUL A. SMITH 1
1. An Economics Framework for Analysis of Policy Issues 1
2. A Political Science Framework for Analysis of Policy Issues 4
3. Integrating Economics and Political Science 6

TOPIC OVERVIEW: THE ART OF TAXATION
THOMAS R. SWARTZ AND L. JOHN ROOS 9

Bibliography 26

INSTRUCTIONAL ACTIVITIES
JOHN S. MORTON 28
Why Study Taxes: Rationale and Objectives 28
1. What Are Your Taxes? 30
2. What's a Fair Tax? 34
3. What's a Good Tax? 38
4. A Brief History of the Property Tax 41
5. Meet Your Property Tax 44
6. The Revolt of California Taxpayers 51
7. Reforming the Property Tax—a Simulation 71
8. A Tale of Two Taxpayers 82
9. Computing and Understanding Your Income Tax 87
10. The Politics of Taxation: Portraits of Two Tax Laws 94

Foreword

Economics-Political Science Project

Although by its very name the Joint Council on Economic Education is obviously committed to improving the teaching of economics, it has developed this Economics-Political Science Series as a contribution to the teaching of the broad social studies field. We believe that all the publications in the series will enable teachers to achieve a number of purposes that rank high among the goals for social studies, and the production procedure for the series demonstrates effective steps and use of personnel to develop social studies instructional materials.

The series is an outgrowth of the Economics-Political Science Project, which was undertaken in 1973. The project came into being because it was recognized that most social issues were becoming increasingly complex and multidimensional and yet social studies teachers were generally unprepared to handle the teaching of such material. As a result, students were not being prepared to understand and act upon crucial matters. The J. M. Foundation had a strong commitment for many years to improve the quality of our nation's citizenship education, and it provided the JCEE with the initial grant to launch the Economics-Political Science Project.

The core of JCEE strategy was to draw heavily upon the experiences and judgment of outstanding social studies teachers in diagnosing what needed to be done and how to do it. The major program recommended to lay a foundation for the project was to conduct a national workshop in which strategically situated social studies teachers could be prepared to teach complex, multidimensional social issues effectively. With this experience as a beginning, it was anticipated that comparable training programs could be provided within states for other teachers. Furthermore, the experience of the national workshop could be used to establish a basis for developing materials for teaching the social issues.

As a preliminary step, pilot programs were held for social studies teachers in North Carolina and Oregon to gain experience and advice regarding the purposes, personnel, content, materials, and procedures for the national workshop. Among the key recommendations that emerged were the following: (1) Participants should include outstanding high school teachers with backgrounds in economics and political science. (2) The workshop should focus on the analysis of major social issues that involve economics and political science. (3) The workshop should focus also on the techniques and resources for teaching the social issues selected. (4) The staff should include personnel capable of providing the essentials of economics and political science; an analysis of the social issues, which would draw upon and show the interrelation of the pertinent topics in economics and political science; and leadership in demonstrating and developing teaching techniques and materials. (5) The entire workshop should be conducted in an exemplary manner so as to serve as a model for later workshops in states and school districts.

The National Economics-Political Science Project Workshop was conducted during the summer of 1974 at Haverford College, using the adjacent city of Philadelphia as a resource for realistically relating the social issues being analyzed. Attending were teams of high school social studies teachers from 36 states who had been carefully selected by their state Affiliated Councils on Economic Education. Evaluations of the workshop indicated that the purposes were achieved to a very high degree.

During the following year miniworkshops dealing with social issues were conducted for social studies teachers in five regions of the nation. These programs were patterned after the national workshop and included teachers and materials from that workshop. Funds for the national workshop and the regional programs were provided by the J. M. Foundation, Exxon Corporation (USA), and the Lilly Endowment, Inc.

It was at this stage that the Economics-Political Science Project turned to the production of teaching materials. With continuing grants from the J. M. Foundation and Exxon Corporation (USA), the JCEE employed four writing teams to develop resource units for teaching major social issues. The units were to be designed to teach social issues analytically, integrating economics and political science in the process, and they were to provide diverse examples and suggestions of units, methods, and resources for classroom use. In order to achieve these aims, each team included an economist, a political scientist, two social studies teachers, and a social studies curriculum specialist. The team members selected had demonstrated their abilities in various phases of the Economics-Political Science Project.

In August 1975 the writing teams were convened by the JCEE for an intensive planning seminar and, drawing upon the experiences and output of the national and regional workshops, they developed the focus, format, and procedures for the Economics-Political Science Series.

It was agreed that resource guides were to be developed for analyzing the following: Health Care Policy; Tax Policy; Economic Stabilization Policy; Government Regulation; Environmental Policy; Housing Policy; and Crime Control and Prevention Policy.

Each resource guide was to contain the following elements: (1) a delineation of the core concepts of economics and political science and their interrelationships; (2) a Topic Overview providing background information for teachers and an indepth economic-political science analysis of the problem area on which the guide was focused; (3) a statement of the rationale and significance of the problem area, emphasizing its present and potential place in the lives of students; (4) an identification of the objectives and outcomes to be achieved from study of the problem area; (5) diverse examples of classroom activities, each designed to achieve one or more of the objectives.

Another major decision reached at that time was that there should be extensive exchange, review, and testing throughout the development process. All the economists and political scientists would react to each other's analyses and they would also receive reactions and suggestions from the high school social studies teachers. The economists and political scientists would review the content of the methodology prepared by the high school teachers and the teachers would exchange their materials among themselves. Beyond all this and of crucial importance, it was agreed that the resource guides would be extensively field-tested in classrooms throughout the United States.

All these procedures have been followed and we have now completed this third guide in the EPS series. We believe the series is unique not only in the separate features it embodies but more so in its composite emphases and contributions: (1) a focus upon social issues of major interest and consequence to students; (2) an emphasis upon the teaching and learning of analytical skills; (3) the development of an understanding of the fundamentals of economics and political science, the interrelationship between them, and the application of both disciplines in analyzing and acting upon social issues; (4) the use of diverse, proven teaching strategies and resources that aim clearly at achieving significant, measurable outcomes.

Another unique quality that can be attributed to this series is the range of people who have been involved in a close, working relationship: college professors and high school teachers; economists and political scientists; specialists in academic disciplines and specialists in methodology; teachers in school systems of varied sizes, locations, and student populations. We believe all of this has proved to be effective and bodes well for the development of social studies materials in the future.

Each publication in the series identifies the people who contributed to its completion, and we extend our appreciation to them for their dedication and competence. On behalf of myself and the Joint Council on Economic Education, I extend a special message of appreciation and commendation to June Gilliard of the JCEE staff for the most praiseworthy ways in which she has coordinated the development and production of the Economics-Political Science Series. She is recognized to be one of the nation's distinguished social studies educators, and her role in this project should provide her with additional distinction. Throughout the project valuable assistance has also been provided by Anthony F. Suglia and S. Stowell Symmes of the JCEE staff and George G. Dawson, director of the Center for Economic Education at Empire State College–State University of New York and formerly a staff member of JCEE.

Although the support of the J. M. Foundation and the Exxon Corporation (USA) has been mentioned previously, we acknowledge again our gratitude to them for providing the means to carry out the project and produce this series.

Of course, the Economics-Political Science Project which led to this series is not completed nor is it ever likely to be. Now will come further use, adaptation, modification, and improvement. Social issues are dynamic, and there will be need for different resource guides in the years to come. We encourage such ferment and shall welcome suggestions that will enable us to join you in doing what is needed to improve the teaching of social studies.

Dr. George L. Fersh
Regional Representative, JCEE
Director, Economics-Political Science Project

Preface

Organization and Uses of Unit Resource Material

Policy decisions affect everyone. Consequently it is important that students acquire the knowledge and skills necessary for understanding the major policy questions facing our society and for participating effectively in the processes of public debate and public decision-making.

Analyzing Tax Policy is the third in a series of resource guides focusing on economic-political analysis of contemporary public policies and issues. The topics for all the units in the series were selected not only because of their current relevance, but also in the belief that these issues will continue to be the focus of public debate for some time to come.

In developing the Economics-Political Science (EPS) resource guides every effort was made to make the material as widely useful as possible. Material contained in individual guides was designed to be used by high school teachers with instructional responsibilities for economics, government, United States history, problems of democracy, or other social studies courses dealing with contemporary social issues.

The resource guide on tax policy consists of four major components, each designed to serve specific curricular or instructional purposes. The Introduction provides a general explanation of the conceptual framework used throughout the series for analysis of policy problems and issues. It also provides a model that teachers may use for extending the study of tax policy or for developing additional units dealing with economic-political analysis of other areas of public debate and concern.

The purpose of the Topic Overview is twofold. First, it provides the teacher with background information on economic and political issues involved in the formation of a national policy on taxation. Second, it serves as a concrete example of how the conceptual framework described in the preface is applied to the economic-political analysis of policy issues.

Why Study Taxes: Rationale and Objectives and the instructional activities deal specifically with instructional questions pertaining to the *why*, *what*, and *how* of teaching about taxation.

About five weeks of study are needed to complete all the suggested instructional activities in the sequence presented. It is not anticipated, however, that every teacher will wish to use the material in that manner. Therefore, the activities are designed so they may be used singly or in various combinations, depending upon the amount of time the teacher wishes to devote to the topics and the needs of the particular student group being taught. To assist teachers in determining which activity or combination of activities is most appropriate for their students each instructional activity has been keyed to the objectives it is designed to achieve.

We wish to express our appreciation to the writing team that prepared the material for this third unit in our EPS Series. To S. Stowell Symmes for his consultation and untiring effort as team coordinator we owe a special debt of gratitude. We are also indebted to the following teachers for their review and classroom trail of the material in its experimental form: Roby Gray Walls, Winston-Salem/Forsyth County Schools, Winston-Salem, North Carolina, and Edward R. McDonnell Sr., Atlanta Public Schools, Atlanta, Georgia. We found their advice extremely helpful, and to the extent possible, their suggestions have been incorporated into the published material.

June V. Gilliard
EPS Project Coordinator
and Director of Curriculum

INTRODUCTION

LAURENCE E. LEAMER AND PAUL A. SMITH

A central purpose of this series is to help students in learning to view society and its problems from both economic and political perspectives. This can best be done through study of specific questions, each of which entails an economic and political analysis of a distinct social problem.

Economics and political science are complex intellectual "disciplines," each having an extensive body of theory and methodology. As such, their applications in the diverse areas of policy decision-making may leave the teacher searching for certain "essentials"—certain core ideas—with which to explain matters to the student. Such essentials can be found in a modest number of basic concepts that mark each discipline. These are presented in separate statements below, followed by a brief discussion of how those concepts may be combined to provide an integrated approach to the teaching of economics and political science.

1. AN ECONOMICS FRAMEWORK FOR ANALYSIS OF POLICY ISSUES[1]

It is useful to think of the concepts that form the basis for economic understanding in terms of several broad "concept clusters." The diagram provided in Figure 1 (page 2) illustrates how these clusters and various subclusters are combined to form a schematic framework for economics curricula and instruction.

Every economy, however it may be organized, faces the fundamental problem that economic resources (natural resources, human resources, capital goods) are limited relative to the practically unlimited wants of people in the economy. How people allocate these resources among many competing human wants varies greatly among different economic systems. One broad class of systems solves this complex problem largely by reliance on tradition (e.g., some "underdeveloped" economies), another one by "command" (e.g., centralized economies such as China and the U.S.S.R.), and a third class by a decentralized market mechanism (e.g., the United States and most Western European nations). In reality, most economies are mixed in their use of the three approaches and in the economic institutions they have developed, and the approaches and institutions change with the passage of time. We focus primarily on the American economic system, but it is important to recognize that other systems face the same central economic problem of *scarcity*, although they deal with it differently.

When examining any economic system it is helpful to look both at its parts (microeconomics) and the whole (marcoeconomics). In microeconomics independent elements can be explored, such as what products are produced, how much a firm produces, how much income a family earns, or why corn prices are what they are. But some problems require an analysis from the perspective of the total (marco) economy. Then economists examine aggregates such as general price levels, gross national products, employment levels, and other phenomena.

In our largely private enterprise economy (leaving government aside for a moment) competitive market prices are the dominant mechanism used to allocate scarce resources. Perfect competition rarely exists in the real world, but the competitive market provides us with a model of how markets "should" work when no individual is a big enough part of the total market to have any personal influence on market price.

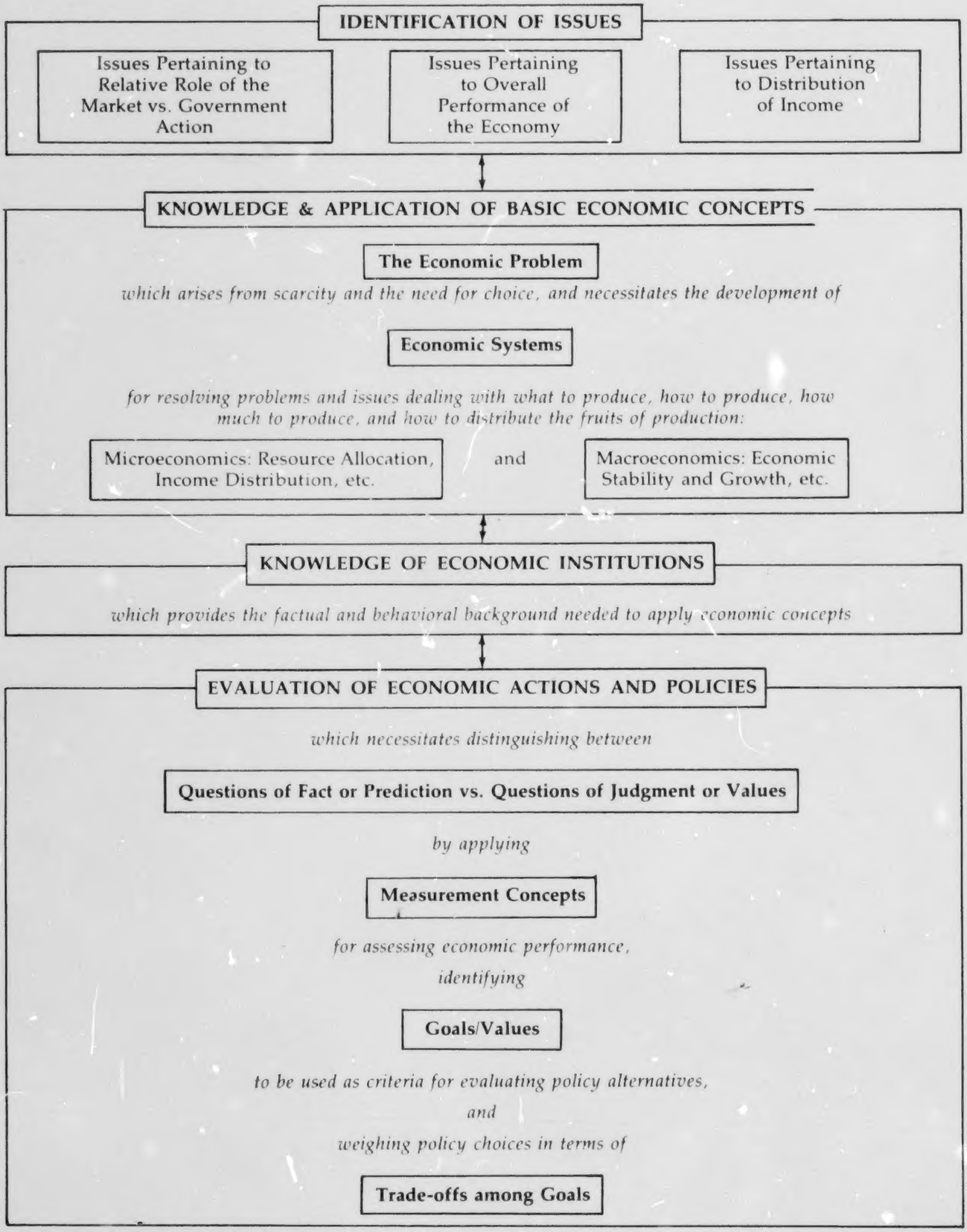
In striving to maximize profits, businesses try to produce at the lowest possible cost those goods and services that consumers are willing and able to buy.

Laurence E. Leamer is professor of economics and director of the Center for Economic Education at the State University of New York at Binghamton. Paul A. Smith is professor of political science and director of undergraduate programs at the same institution.

[1] Adapted from the January 1977 unpublished report prepared by W. Lee Hansen, chairman, Framework Committee for the Joint Council on Economic Education Master Curriculum Project.

FIGURE 1
Framework for Analysis of Economic Policies and Issues

Systematic analysis of economic policies requires:



IDENTIFICATION OF ISSUES

Issues Pertaining to Relative Role of the Market vs. Government Action

Issues Pertaining to Overall Performance of the Economy

Issues Pertaining to Distribution of Income

KNOWLEDGE & APPLICATION OF BASIC ECONOMIC CONCEPTS

The Economic Problem

which arises from scarcity and the need for choice, and necessitates the development of

Economic Systems

for resolving problems and issues dealing with what to produce, how to produce, how much to produce, and how to distribute the fruits of production:

Microeconomics: Resource Allocation, Income Distribution, etc. and Macroeconomics: Economic Stability and Growth, etc.

KNOWLEDGE OF ECONOMIC INSTITUTIONS

which provides the factual and behavioral background needed to apply economic concepts

EVALUATION OF ECONOMIC ACTIONS AND POLICIES

which necessitates distinguishing between

Questions of Fact or Prediction vs. Questions of Judgment or Values

by applying

Measurement Concepts

for assessing economic performance,
identifying

Goals/Values

to be used as criteria for evaluating policy alternatives,
and
weighing policy choices in terms of

Trade-offs among Goals

In some cases they also seek to influence consumer demands through advertising and other selling activities. They draw productive resources (such as labor, land, and machinery) into those enterprises where they will contribute most to meeting consumer demands. While doing so, businesses pay out incomes to workers, landowners, and other suppliers of productive services who are also trying to maximize their economic returns by getting the best possible value or price for what they have to offer. These incomes, in turn, make it possible for income receivers to bid for goods they want. Thus markets in which prices rise and fall in response to changing demands and supplies provide the mechanism that links consumers and businesses, each group seeking to make the best of its position and abilities, yet each dependent upon the other. In economics, this is described as a circular flow model of the economic system. Individuals and businesses who save part of their income and make these savings available for investment in new productive facilities or in human beings increase society's capacity to produce in future years. As a result another circular flow exists, connecting those having funds to invest and those seeking funds to be invested.

Individual freedom of choice is central to the way the largely decentralized, market-directed American economy defines its goals and allocates its limited resources. But those individual freedoms of the consumer, wage-earner, investor, and entrepreneur are limited by laws and social institutions protecting the individual and society. Thus, markets and prices, reflecting shifting demand and supply conditions, are the main regulators of the allocation of scarce resources in the production of the most desired goods and services; but governments, unions, trade associations, and other institutions help to set and enforce the rules under which competition takes place, and sometimes participate actively in the process of production and distribution.

There are two general types of queries fundamental to understanding policy issues. One concerns questions of fact or prediction: *What is known* about economic behavior? Or, if we undertake some action, what will be the predicted effects? The other type concerns questions of judgment or values: *What ought to be done* to alter economic behavior? Should we undertake a particular policy or not, given that various people and groups may be differently affected? The failure to distinguish between questions of *what is* and *what ought to be* is the cause of endless confusion and can lead to inappropriate policy analysis.

As we sort through the vast array of questions and issues coming at us from newspapers, television, political campaigns, and our involvement in economic life, we find that most of them can be grouped into the following three broad categories:

One major set of issues concerns the relative role of private market forces and collective governmental actions. On these issues we are interested in knowing "what happens," or what is likely to happen, in response to a change in the demand for, supply of, and the resulting price of individual goods and services. To changes in the supply and demand for labor and capital? To new developments in technology? These questions call for a description of how the total economic system or its parts behave under conditions of free competition and varying degrees of restriction. A related set of questions pertains to "what ought to be done." What ought to be done, say, when people don't like the higher prices they must pay for individual products (e.g., oil, gasoline, sugar, or coffee)? This involves thinking about whether to rely upon the operation of market forces or to rely upon collective action via government policy such as price ceilings, rationing, special taxes, regulation (e.g., truth-in-lending laws, environmental controls), and the like. Another way of phrasing the question is: When "should" direct government action be used to allocate resources differently from the way the price system would allocate them? For example, should local government act to allocate energy sources, such as oil or gas? Should government continue to subsidize shipbuilding, farming? Most of these questions concern economic efficiency. To consider appropriate public policy about such questions, one must first identify the consequences of choices, analyze them relative to desired results and values, and then make what one believes to be the most favorable policy decision. But other questions of collective action relate closely to economic equity. For example, should government raise gasoline taxes or use a direct quota rationing system to allocate relatively unlimited gasoline supplies? Only after a detailed examination of all the possible effects would one be in a position to reach a judgment.

Another important category of issues relates to the economy's overall performance as reflected by the rates of inflation, unemployment, and economic growth. What "causes" inflation? What "causes" unemployment? What "should be done" about inflation or unemployment? What policies should be pursued when unemployment and inflation exist simultaneously? There is an obvious overlap between these issues and those mentioned above in explaining recent inflation and unemployment? What "causes" economic growth? What are some of the benefits and costs of economic growth? What is the long-run relationship between economic growth and resources? Among economic growth, population, and employment? Between economic growth and the environment? What is the "appropriate" rate of growth? Should we attempt to speed up or slow down economic growth, or pursue a "no-growth" policy? What is the best way to implement our policies?

A third major category of issues relates to the distribution of income produced by the operation of market forces and the redistributive effects of government action. Again, it is important to separate "is" from "should be" issues. What "is" the current distribution of income? What produces this distribution? To what extent does this distribution perpetuate itself? What is the effect of existing and of proposed government policies on income distribution? "Should" policies be adopted that are designed explicitly to change the distribution of income or economic well-being? "Should" the tax structure be made more or less progressive? "Should" schools continue to be financed largely by property taxes? Should policies designed to improve economic efficiency be adopted if they affect the distribution of income? Should government subsidize the housing of elderly and low-income renters? These issues, some immediately visible and others hidden just below the surface, appear to be critical to virtually all the questions posed earlier. They come up in any evaluation of how the market system works, in determining whether collective decisions alter individual economic decisions, and in assessing the extent to which inflation, unemployment, and growth affect the general well-being of the population. Who gains and who loses, and who should gain and who should lose are the questions that best summarize what is at stake here.

There are several reasons why unequivocal answers to these and similar questions are not readily available. Economic systems are complex, and an understanding of these systems requires a conceptual framework, factual and cultural information, the application of analysis, the making of judgments, and the determination of action to be taken. Moreover, our ability to know exactly how effectively the economy and its components function is limited by difficulties in obtaining accurate and timely measurements of economic activity. Finally, a variety of unanticipated events affects economic activity, and thereby makes it difficult to predict accurately the results of specific economic decisions. Unlike the physical sciences, carefully controlled experiments are difficult to undertake in economics.

Even if our understanding of the economy and economic decision-making were vastly improved, we still could not expect all disagreements on economic issues and questions to be eliminated. Certainly, some disagreements will be resolved as our understanding is increased. Many disagreements will persist, however, because of differences in judgments about the actual or predicted effect of specific decisions, and still others will remain because individual economists, as do most individuals, adhere to different sets of values.

The heart of economics is decision-making—choosing among alternatives. But economic decisions are not made in a vacuum. Rather, they are made in the light of a set of goals. These goals vary from one society to another, from one group to another within a society, and from one individual to another within a group. Among the goals most evident in the modern world and particularly in American society are freedom, economic efficiency, equity, security, stability (full employment and the absence of inflation), and economic progress.

Economic decision making involves the *opportunity cost principle*. It refers to what must be given up, i.e., to opportunities foregone when scarce resources are used to produce particular goods and services. A decision to produce one good entails giving up the possibility of producing something else that uses the same resources. The cost of producing that "something else" is the opportunity cost of producing the good chosen. For an individual, the opportunity cost of something purchased is the price of whatever could have been bought instead. Opportunity costs for a society are the costs of the alternative uses to which it could have put its productive resources.

A person or a group choosing one good instead of another is making a *trade-off*—that is, giving up less of one thing for more of something else. Society has to make trade-offs too, e.g., between its need for more energy and its desire to preserve the environment. Essentially this involves comparing the various costs and benefits of each of the alternatives and determining how these costs and benefits will affect different groups within the economic system.

Goals or criteria provide a means of evaluating the performance of not only an economic system and parts of it, but also of existing programs and proposed new policies. However, many of the goals conflict, and difficult trade-offs have to be made. Examples are farm price supports, which promote security but reduce efficiency; minimum wage laws, which can be thought of as equitable but may increase teenage unemployment; and wage-price controls, which may restrain inflation, but also reduce efficiency and freedom. Economic analysis does not make explicit value judgments in these policy areas, but it does help people to understand the nature of the trade-offs so that they can form their own judgments in the light of their own values. Perhaps most important, it encourages use of a reasoned approached in dealing with controversial economic issues.

2. A POLITICAL SCIENCE FRAMEWORK FOR ANALYSIS OF POLICY ISSUES[2]

The political scientist uses certain major concepts to find meaning in the world of politics. These concepts direct attention to the significant qualities of any political system and provide measures of its effectiveness. As in other intellectual disciplines, there is considerable disagreement in political science about what things are important and how they should be studied. Nevertheless, while political scientists might argue about exact definitions and preferred approaches, the following concepts provide us with working tools for political analysis. Each of the problems we shall be addressing in this series is a problem of public policy, and thus its solution—or nonsolution—must involve political decision-making. These concepts will provide the means for understanding that process.

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[2] The statement of political science concepts was prepared by Professor Smith, with the consensus of the other political scientists involved in the project.

12

The first concept is *authority*. By this we refer to the legitimacy that a political leader or procedure or policy has. A political action is authoritative to the extent that it is accepted as right and proper by the community it affects. Authority, therefore, is a relationship that arises not from the will of governors but from the beliefs of the governed. What gives a political decision authority is usually its connection with some basic *procedure* or *institution* that the community views as a fundamental value. Often this is expressed by some historical event or document. For example, we say that the U.S. Constitution gives the President authority to command the armed forces and the Congress authority to declare war, while neither has authority to do both.

Of course there are many kinds of authority—in art, science, religion, and so forth—all involving standards of performance or truth. The distinctive aspect of political authority is its relationship to social power. "The state," we often say, embodies the authority to make "final" decisions affecting social values or, more specifically, to use coercive force. Political authority is a tricky concept because it is often confused with power and because its exercise almost always means that some members of the community must do things they don't want to do. This complicates the quality of approval implied by authoritative acts. Authority wanes as this complication grows.

Our second concept is *power*. Power is the capacity to get people to do things they would not otherwise do, with *political* power activating instrumentalities of collective sanction—customarily the state. Obviously, power has many sources. It can "come out of the mouth of a cannon" or it can rest on such forces as love, money, oratory, knowledge, or authority. Like authority, power expresses a relationship. It rests on shared values and unequal resources. Power is authoritative only when its exercise is accepted as legitimate by the community. When power goes beyond authority, deep conflicts occur in the community and governments must use more force and coercion to sustain themselves and carry out policies. We ordinarily think of democratic government as a model in which power and authority overlap and where explicit procedures of consent are used to determine authority. The distribution (who has how much) and exercise of power are thus key factors in the way problems of public policy are handled in the political system.

Although we have used the term "public policy" as if it were a simple and commonly understood concept, in recent years political scientists have given considerable attention to its meaning and analysis. One reason for this is that it is often difficult to know when an action is or is not part of a "policy," and when nongovernmental institutions actually might be "making" policy. For our purposes, this third concept refers to *patterns of action* by government that are directed at recognized social problems. Thus we think of public policy not as one action but as a *series* of actions having political authority and aimed at some coherent set of social needs. Policy, therefore, is something that results from what government does and that reflects the power, values, and skills of the political community.

In order to deal with the multiple group and individual actions that go into policymaking, political scientists often use the concept of *process*. This refers to the dynamic relationships—especially the relationships of influence—among those who take part in the various steps through which policy is suggested, formulated, authorized, changed, and so forth. Sometimes the "policymaking process" refers to what happens in the political system as a whole, and sometimes to actions leading to a particular policy or set of policies. In either case, process is always active in nature, and the term emphasizes that governing or policymaking cannot be described adequately by formal structures of authority or power.

This brings us to our fifth concept, *institutions*—well-established and "structured" patterns of behavior through which power is exercised and governmental actions are taken. Congress, the Presidency, the Supreme Court, political parties, elections, regulatory agencies, and city councils are all political institutions. Each of these is composed of a distinct structure of rules, procedures, roles, expectations and rewards; and each serves certain functions. In America institutional development is well advanced and policymaking is largely channeled through certain types of political institutions designed to "produce" policy. Since institutions are by definition well-established, and elements of their structure are often defined by formal rules (laws), political institutions tend to embody large amounts of authority in their respective areas of jurisdiction. Indeed, we often refer to persons who hold positions or offices in government as "authorities." So strong is this institutionalization that political activities outside of them are often viewed with suspicion, if not outright opposition. For example, street or courtroom demonstrations are usually treated as highly controversial and "out of order" in the American community.

Political institutions, therefore, tell us a lot about public policymaking. As embodiments of authority, they are preferred channels for political action and power. They are not only natural targets for those in the community who wish to influence policies, but also are guides to who has community power. For example, congressional committees are the focus of political activity by those community interests over which the committees have jurisdiction; hence, those same committees usually become biased in favor of those very interests. The same thing happens to regulatory agencies. It is easy to see, therefore, that most policy processes occur in and around institutions. Moreover, important relationships develop between political institutions and other types—economic institutions, for example. Business corporations, labor unions, and markets have close and complex ties to political institutions ranging from committees of Congress and federal regulatory agencies to small-town governments.

Our sixth and last concept is political *participation*—activities that are part of political decision-making, the results of which are supported by the power and authority of the state. The first point to be made about participation is its diversity. Voting is probably the form of participation most Americans would think of before any other, since free elections are an institution in America. But for those of us interested in public policymaking, other forms of participation are more useful—writing letters to members of Congress, direct lobbying, or contributing to political campaigns, for example. Bribing or assassinating or providing information to government officials are other examples. These remind us that some forms of participation are more legitimate, more costly, or more effective than others.

A second point about participation is apparent from the above description: some members of the community participate more than others. Although it is not easy to summarize the enormously complicated nature of this point, as a rule the more resources of wealth, skill, or status people have, the more and more effectively they participate. The fact that this generalization can be made for every known political system has obvious implications for the distribution of power, the nature of policymaking, and the outcomes associated with policies. Democracies pride themselves on expanding participation, and this is a public value in the United States. Even so, the general relationship between resources and participation remains. Moreover, participation is greater in some areas of policymaking than in others. For example, fewer Americans "decide" the level of defense expenditures each year than where bridges will be built over inland waterways. Participation must be measured and judged not only in terms of amount, but also in terms of quality and breadth. Some men and women might participate with great intensity (and effect) in a relatively narrow area of policy, while others might participate over a wider range and with less effectiveness in any one area. Thus political participation is many-faceted and complex.

Looking back on the six concepts we have singled out for special emphasis in the understanding and application of political science, we see that each one in itself has a good change of becoming an arena of controversy in the policymaking process: Does a particular policy represent an "abuse or a maldistribution of power"? Did the policy process wrongly exclude deserving groups in the community? Does government intervention constitute a "misuse of authority" or the "abridgment of rights"? The reason for this is that these concepts not only involve the *description* and *analysis* of politics, but the *evaluation* of politics as well. Each carries with it values and standards: How much power is good? What extent of authority is proper? Who should participate, and in what way? And beyond this is the question of political *effectiveness*, the capacity of the political system to act, to work, to get things done. Remember that Mussolini was originally complimented because "he got the trains to run on time" (which later turned out to be questionable). So the effectiveness of a governing arrangement or of a public policy also becomes (and hardly surprisingly) a criterion of value.

Finally, we are left with the question, "What is politics?" Political (or "public") authority, power, process, policy, institutions, and participation all involve conflicts of value. Politics is the working out of these conflicts so that policies are made and governments can function. In democracies politics is marked by bargaining, compromise, and accommodation, and it is this meaning of politics that is most common in America. Where there is policy unanimity within a political community or where policies are imposed on a community, there is no place for politics. Politics, therefore, occurs where there is conflict over social policies and where those conflicts are resolved with a minimum of value loss to any particular interest. Some members of the community will win, others will lose. Some will get more than others. But the gains and losses will be limited by the process of politics. Politics is often looked upon as a necessary evil, with suspicion and skepticism. But as you consider the different problems of public policy, and the conflicts and controversies over solutions that divide the community, imagine what policymaking would be without politics. It would be policymaking of absolute unanimity or absolute coercion, or both. Neither of these is consistent with our basic ideals of individuality and the free and vigorous expression of ideas.

3. INTEGRATING ECONOMICS AND POLITICAL SCIENCE

While economics and political science are separate disciplines, it is important to keep in mind that they have much in common, and that in effective analyses of public policy they almost always must be used together. Indeed, "political economy" itself has a long and distinguished tradition as an intellectual discipline. The similarities and differences between economics and political science are summarized in Figure 2.

Both economics and political science are concerned with human values and with the decisions about those values that have social consequences. Both disciplines are social sciences, which means that both have similar standards of scientific logic, evidence collection, and construction of theory. In short, they share a common emphasis on verified explanations of patterns of social life. Both, therefore, are concerned with social problems. See Part II in Figure 2 for a summary of the four steps in a rational approach to the study of social problems.

But the two disciplines differ in their framework for analysis, institutions, fundamental concepts, and type of evidence or "data" they most commonly employ. Economists and political scientists have therefore developed different areas of expertise. Economists are experts on the vast array of stable and changing conditions that are related to the distribu-

14

FIGURE 2

THE SUBJECT MATTER OF POLITICAL ECONOMY:

A Framework for Analysis of Political-Economic Policies and Issues

ECONOMICS **(Economic Science)**	**POLITICS** **(Political Science)**

FOUNDATION

THE ECONOMIC PROBLEM (Wants > Resources → Scarcity, i.e., our wants exceed available resources and therefore scarcity exists)	THE POLITICAL PROBLEM (Conflicts of interest)

THUS

I. Political economy is the study of the **methods** by which society—

employs its resources (human, capital, natural, time) productively for the fulfillment of human wants.	resolves conflicts of interest over the authoritative allocation of values; thus a study of power.

Toward these ends

Economics is a study of how a society decides—	Politics is a study of how a society decides—
a. **What** wants to produce (i.e., what wants to fulfill) and **how much** to produce	a. **What** goal values are to be sought and given authority
b. **How** to produce most efficiently (i.e., how to allocate resources most productively to their alternative possible uses)	b. **How** societies are to be organized for the pursuit and use of power and authority (i.e., mechanisms for resolving conflicting values, achieving social goals)
c. **For whom** to produce (i.e., who is to get what and how much and how is this to be decided)	c. **For whom** the organization exists (i.e., who gets what; whose goals are served?)

II. Political economy is the study of **social problems** relating both to the functioning of the organization as a whole and to its particular institutions.

Both economics and political science usually employ a problems approach involving four steps—

a. **Definition of the Problem**—What desired goals are believed to be inadequately served by existing institutions? How does "what is" conflict with what many think "ought to be"?

Economics is concerned with problems relating particularly to the goals of—	Politics is concerned with problems relating particularly to the goals of—
1. Efficiency and productivity	1. Justice in the exercise of power
2. Growth	2. Equity in the distribution of power (income, deference, security, influence)
3. Stability (both full employment and general price stability)	3. Freedom (both limits on the use of power and access to resources needed to realize individual potential.
4. Security	4. Effectiveness
5. Equity in the distribution of income	

b. **Understanding of the problem**—What concepts, what analytical tools, what facts do economics and political science have to contribute to an understanding of the problem and its proposed solutions?

What do we know about how productively resources are being employed for the fulfillment of human wants related to the problem and the consequences for other values?	What do we know about value conflicts (i.e., conflicts of interest) related to the problem, how they are being resolved, and the resulting allocation and use of power?

c. **Public policy alternatives**—What are their economic and political implications? How may citizens, as individuals and groups, influence policy decision-making?

What will be the probable consequences, both in the short run and long run (the seen effects and the unseen), for the economic goals stated above?	Who is proposing what and why? How does private interest relate to public interest? What are the probable consequences for the political goals identified above?

Thus what policy alternatives will bring the greatest net realization of values?

I.e., a more optimal allocation (use) of resources (so that their marginal value products in all alternative uses will be equal).	I.e., resolution of the problem with a minimum value loss to any participant and a maximum value gain to all.

Which policy alternative is most compatible with one's economic philosophy (i.e., one's view of the proper role of government in relation to the economy)?

d. **Action**—How may one implement one's views?

How does one act as consumer, producer, as a member of an interest group to bring about desired changes?	How may one as a citizen or leader participate in politics to be most effective in bringing about desired changes?

tion and exchange of goods and services. They concentrate their attention on the institutions or arenas where these economic decisions take place. The most notable arenas are what economists call "markets," in which prices are determined by the decisions of buyers and sellers. Here the data are commonly in the form of units of economic value—*money*—which have the great advantage of precision and comparability.

Political scientists, on the other hand, are experts on the distribution and use of social power and on the institutions through which that power is mobilized and made authoritative. Most notably, these are institutions of government, political parties, and elections. Since there are no measures of power or authority comparable to those of money and market value, political scientists use various forms of data to study politics, including votes, opinion surveys, laws, and judicial decisions. It is also true that just as economists recognize that actions of government affect economic conditions directly and indirectly, political scientists know that economic resources are sources of social power and that economic issues are a major element of politics.

Insofar as alternative social goals can be assigned economic values and markets exist in which those values can be expressed and measured, economic analysis can be used to judge the desirability of proposed policies. Cost-benefit analysis is one way of determining desirability: actions will be undertaken if the benefits exceed the costs, but will not be undertaken if the costs exceed the benefits.

When, however, human values cannot be measured as economic goods, or when markets are for some reason (such as monopolies) not effective in their pricing and distribution functions, then policy decisions tend to be moved from the economic to the political arena. The realm of politics can encompass conflicts among alternative human values and social goals of all sorts, with the resulting policies being enforced through the power and authority of government. For each of the social problems treated in this series, you will find it interesting to observe how economic and political factors together contribute to both the cause and possible solutions of the problems, and how scientists analyze in their distinctive ways what the problems are and how they might be solved.

While we recognize the importance of the other social sciences and the extent to which they enhance one's understanding of public problems and issues, our aim here is to combine only two of these disciplines: economics and political science. The teacher resource materials contained in this and other units in the series provide concrete illustrations of how economics and political science may be combined to enable students (1) to analyze and understand policy issues and (2) to participate effectively in the political process through which policy alternatives are examined, promoted, and acted upon.

TOPIC OVERVIEW

THE ART OF TAXATION

THOMAS R. SWARTZ AND L. JOHN ROOS

> "To tax and to please, no more than to love and to be wise, is not given to men."
>
> Edmund Burke, *On American Taxation* (1774)

Introduction

Not all students of government are as pessimistic about pleasing the taxpayer as Edmund Burke was. However, most recognize that it is a formidable task. Indeed, an epigram attributed to J. B. Colbert, Louis XIV's minister of finance (c. 1665), stated that: "The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing." Elected officials recognize that a rise in rates—or even the present level of taxes—may place them in political jeopardy, but they also know that taxation is required in order to sustain governments. In other words, taxes are here to stay. Charles Dickens vividly noted this fact in *David Copperfield*, in which one of his characters, Mr. Barkis, says, "It was as true . . . as taxes is. And nothing's truer than them."

Taxes may be here to stay, but how long any particular level of taxation will last has become a major uncertainty. This was forcefully demonstrated in 1978. There had already been a rising volume of grumbling about tax burdens around the country. In a number of states, limits had begun to be put on taxation; other states had scheduled votes for the November 1978 elections on various measures to limit taxation. But before that, on June 6, 1978, to be precise, the tax issue figuratively exploded into political prominence. On that day the voters of California approved Proposition 13, an initiative that reduced the level of property taxes and limited any future rises in them. Furthermore, the proposition, which went into effect on July 1, 1978, required a two-thirds vote of "all members elected" to each house of the state legislature for passage of an increase in any state tax and a two-thirds vote of the "qualified electors" for an increase in any local tax. The meanings of these stipulations are unclear and may require judicial interpretation. The proposition, however, did not ban all new taxation. (More details on the background and effects of Proposition 13 appear on pp. 16–17.)

The ripples from the shockwave of Proposition 13 spread rapidly across the country. Holders of political office everywhere quickly saw that the voters of California had given tangible expression to resentments about taxes and about government in general that were also felt by untold millions of taxpayers everywhere. Taxation, therefore, quickly became an issue in several states that previously did not have laws on their books or proposals before their legislatures, setting limits on taxes or on government spending. (A limit on spending would, of course, indirectly serve to limit any increase in taxes.)

Repercussions were also felt in Washington. Efforts to keep a tighter rein on federal spending were reinvigorated and long-standing attempts to require the federal government to maintain a balanced budget acquired new life. A bill to cut federal personal and corporate income taxes by a total of 33 percent over a three-year period gained more supporters. The backers of the latter bill maintained that tax rates were so high that they discouraged efforts to earn more income. Proponents argued that *lower tax rates* would encourage more work and more enterprise and thus actually eventually result in *higher tax collections.* Many of the proponents of large tax cuts based their arguments mainly on the analytic scheme of Arthur Laffer, professor of business economics at the University of Southern California. The pros and cons of that scheme, known as the Laffer curve, appear on pp. 20–23, below.*

The events of 1978 were an effective reminder that taxation, or more precisely the art of taxation is not undertaken in an economic or political vacuum. Economists and political scientists recognize that the ability of the public sector to impose and collect taxes is constrained. But the economic constraints are quite different from the political ones, and on some occasions economic constraints are in direct conflict with political goals. The aim of this analysis is to show how politics and economics interact in the making of tax policy in the United States. Knowledge of this interaction is essential if U.S. taxpayers are to understand the hodgepodge of taxes they face each year.

What Role Do Taxes Play in Our Economy?

Taxes are compulsory payments made chiefly by individuals and businesses to support government functions or programs, and the way governments obtain and use funds has significant economic effects. Taxes essentially play three roles in our economy: (1) they affect the allocation of resources; (2) they affect the distribution of incomes; (3) they help moderate the economy's ups and downs.

We typically think of taxes as supporting such things as national defense, the court system, police and fire protection, and schools. These are examples of what economists call the "allocative role of taxes." Taxes are "allocative" in the sense that they reduce consumer sovereignty—the power of consumers to decide how they will spend, i.e., "allocate," the total income they receive. Instead, some spending decisions are made collectively through the political process. Thus, taxes are an excellent example of the use of government authority to supplant decisions of individuals, which might have been different. The same situation prevails in respect to the total income of business. True, individuals and businesses can affect the direction and magnitude of public expenditures. In the political process, however, one voice may not be heard as clearly as another.

Taxes can affect how business and consumers allocate their spending in other ways as well. Taxes can be imposed directly upon the productive process and may thus alter the "relative" prices of the factors of production—land, labor, and capital. Such taxes ultimately affect the prices of the goods or services produced by the factors of production. Consider the allocative impact of high property taxes in many of our cities in relation to comparatively lower property taxes in the surrounding suburban areas. Tax differentials of this kind are, at least in part, responsible for the relocation of some business firms. Similarly, excise taxes on certain consumer goods or indirect business taxes will alter the use of resources because relative prices are also changed thereby.[1]

Although the allocative role of taxes is extremely important in our federal system, it is not the only part played by taxes. Taxes also affect the "distribution of income." The costs of government are not shared equally: some taxpayers pay more than others for the presumably equal benefits of government programs. And taxes on personal income constitute the largest part of all taxes collected in the United States.

Taxes on personal income can be progressive, regressive, or proportional. If a particular tax is progessive, tax liability as a percentage of income will increase as income increases. That is, the income taxes owed by low-income persons will be a smaller percentage of their incomes than would be the case if their incomes were higher. If an income tax is regressive, tax liability as a percentage of income will fall as income rises. That is, lower-income persons will pay a larger percentage of their incomes for tax purposes than higher-income persons.[2] A proportional tax is one for which the liability as a percentage of income is the same regardless of the amount of income.[3]

Traditionally, economists have assumed that residential property taxes on the whole tend to be regressive, since low-income families must typically spend a greater percentage of their income on housing than do higher-income families.[4] If high- and low-income families are both taxed at 10 percent of the true market value of their properties, tax liability as a percentage of the income of poorer families will be greater than that of more affluent families. By a similar logic, excise taxes on luxury goods are considered to be progressive, since higher-income groups typically spend a greater share of their income on such goods than do lower-income families.

We have seen that the tax system can alter the initial or "pretax" distribution of income in several

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***Editor's Note:** We have included these statements on the Laffer Curve as well as one on the question of business taxation even though there are no specific classroom activities on these subjects in the Instructional Activities that appear later on. We did so in order to provide background information to teachers on matters of considerable current interest in respect to tax policy.

[1] Franchise taxes (taxes a business pays in order to operate in a given state or city) and property taxes are examples of indirect taxes; so-called because their costs may be passed on to customers as an undifferentiated part of the price, unlike, say, a typical sales tax.

[2] It should be emphasized that regressivity refers to the "rate" of taxation, not the absolute dollars paid. Under most forms of regressive taxation, higher income persons pay absolutely more dollars in taxes than low-income persons, but the dollars paid in taxes as a percentage of income nevertheless fall the larger the income. For example, if one family's income is $10,000 a year and its tax liability is $1,000 and a second family's income is $20,000 with a tax liability of $1,500, this tax would be regressive: the tax as a percentage of income falls from 10% to 7½%, even though the absolute dollars paid are greater for the family with the larger income.

[3] Taxes on wealth, e.g., property taxes and inheritance taxes, can be classified under the same three heads mentioned here.

[4] This assumption has been challenged by some economists in recent years. Although the challenge seems to carry less force for residential property than for nonresidential personal property (examples of nonresidential property taxes are given in footnote 14), there is empirical evidence that economists have overstated the regressive nature of the property tax.

ways. It can increase income inequalities by imposing regressive taxes. It can reduce income inequalities by imposing progressive taxes. Or it can leave existing income inequalities unchanged by imposing proportional taxes or by offsetting the effects of some progressive taxes by use of other taxes that are regressive.

A third role taxes play is to moderate the ups and downs of the economy. This is what economists call the "stabilization" role. The ability of a tax to stabilize the economy depends upon the responsiveness of tax receipts to changes in the level of income. Economists call this responsiveness the "revenue elasticity" of a tax. A tax is elastic when a small increase in the level of income will substantially increase tax revenues while a small decrease in income level will substantially decrease revenues. If accompanied by appropriate government expenditure decisions, an elastic tax such as the personal income tax can help stabilize the economy. Whenever the economy is growing and income increases, a greater percentage of that income will be withdrawn from the private sector in the form of taxes. If the public sector sterilizes these tax receipts—in other words, holds them idle—the rate of economic growth as well as any tendency toward an outbreak of inflation will be slowed. During a period of economic recession, any decline in income will result in a fall in tax receipts, and thus reduce taxes as a percentage of income. A reduction in tax collections in combination with continued or accelerated spending by the government sector will moderate or even reverse a recession.

Some taxes, such as the real property tax, are less responsive to changes in income. These and other taxes that have a low revenue elasticity will, in the short run at least, tend to reinforce any trend toward economic expansion or toward recession. When the economy is expanding, receipts from these taxes stay constant or grow only moderately. At such times, these taxes fall as a percentage of income, and thus more is left to be spent by the private economy. During the onset of a recession, tax receipts remain constant or decline comparatively little. These low-elasticity taxes then increase as a percentage of personal income. This relative increase in tax liability will further dampen economic activity until the government's usual expansionary expenditure policy during recessions is felt.[5]

What Is the Nature of Tax Authority?

Taxation, perhaps as much as any other function, illustrates the fundamental nature of government authority. Authority refers to the legitimacy that a political leader or procedure or policy has. Through its authority to tax, government modifies the market's allocation of resources. Since the market is conventionally viewed as by and large the most efficient means of allocating resources, from a strictly economic point of view taxation is deemed generally to lead to inefficient allocation. However, national, state, and local governments in the United States do levy taxes for many purposes, e.g., protective, judicial, educational, which the vast majority of taxpayers approve of. Therefore, the strictly economic point of view may not always be considered to be the most important—even by economists.

In order to collect taxes, a government needs not only authority but also power, which refers to the ability to get persons to do things they would not otherwise do. In the United States, the Constitution authorizes government to use coercion to levy and collect taxes through appropriate procedures and institutions. Fortunately, the need or use of coercion is comparatively rare. Moreover, the power of coercion is not absolute. If taxpayers have a grievance against the tax authorities, they have the right of judicial appeal, and it is not rare for them to win. Still, for many Americans, the payment of taxes is one of their most direct experiences with the exercise of state power, even if that power usually is not displayed but merely implied.

Once the matter of power is raised, a key political question comes up: Who determines what tax policy will be? Not all citizens can influence government in the same way or to the same degree. We will return to this problem.

What Are the Bases for Taxation?

The economist recognizes three economic bases for taxation: income, consumption, and wealth. These tax bases reflect a taxpayer's capacity to command resources in a market economy, that is, to buy goods and services. If taxes are imposed and the taxpayer's own purchasing ability is thus diminished, the market will respond with a different allocation of resources, that is, it will produce and offer a different pattern of goods and services. Some taxes do not vary with economic activity, and since taxes that employ noneconomic bases are relatively insignificant in the United States, they will not be considered in this analysis.

INCOME. Income is the most important tax base in the U.S. tax system. The federal government, the state governments, and even some local governments tap this lucrative source. The most readily recognizable kind of tax on income is that on personal income. However, there are other income-related taxes: payroll taxes, such as the social security tax—which is levied on employers, on recipients of wages and salaries, and on the self-employed—and the tax on corporate income.

As we have seen, the distinguishing characteristic of income-related taxes in the United States is that tax liability varies with changes in the taxpayer's income. If income increases, tax liability increases, and vice versa. Taxpayers already paying the least possible tax in relation to their income can legally reduce their tax liability—lower their taxes—only by acting to lower the amount of their taxable income received. Carrying the matter one step further we see that there is a disincentive effect implicit in the income tax—a restraint on the inclination to earn more money. From the economist's point of view, this disincentive effect can be critical. If tax rates are pushed high enough, taxpayers will begin to spend more time at leisure instead of working to earn as much income as before the rate increases went into effect. If this happens on a wide enough scale, total output in the economy will be less than is potentially possible.

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[5] The stabilization function of taxes is, in general, assumed by the federal government's tax system rather than by the systems of state and local governments.

CONSUMPTION. Taxes on consumption can be levied on all purchases of goods and services, as a truly general retail sales tax would. Or, taxes on consumption can be restricted to a specific group of commodities such as tobacco, alcoholic beverages, and gasoline. Consumption-related taxes—termed "excise" taxes—provide significant amounts of revenue for state governments. Indeed, general retail sales and excise taxes account for approximately 50 percent of total state tax receipts.

As in the case of income-related taxes, there are disincentives associated with consumption-related taxes. The tax liability for consumption taxes is a function of the tax rate and the amount expended on taxable commodities or services. Thus the only way taxpayers can avoid or minimize this tax is by reducing their consumption of those taxable goods and services. Taxpayers may well make such a decision under certain circumstances. Assume that a general sales tax is raised from a modest rate to a quite significant one. That will generally lead to some avoidance of spending and to greater consumer savings—at least for a time.

WEALTH. The most significant tax on wealth in the United States is the property tax. This tax comprises about 95 percent of locally generated receipts and therefore constitutes the financial backbone of a majority of local governments.

Since the amount of liability under a wealth tax depends on the dollar value of taxable assets, there will be a tendency for taxpayers to reduce the size of their wealth holdings or to shift to nontaxable wealth holdings in order to reduce their tax liability. If wealth taxes lead to lower holdings of wealth, such taxes act to encourage consumption and discourage saving.

THE THREE BASES AND AN INTEGRATED TAX SYSTEM. Recognition of the various disincentives associated with income-, consumption-, and wealth-related taxes is important in putting a functionally balanced tax system into place. All three tax bases must be employed. The more one base is overused relative to the other two, the more disincentives will be introduced into the economy.

In part, current tax policy under our federal fiscal system has recognized this fact. As Table 1 indicates, all three bases of taxation are employed in the United States. Income-related taxes—the personal income tax, the corporate income tax, and payroll taxes—dominate at the federal level. Indeed, 84 percent of all personal income taxes, 85 percent of all corporate income taxes, and 84 percent of all payroll taxes were collected by the federal government in 1975–76. At the state level, consumption-based taxes dominated: state governments collected 85 percent of all sales and 50 percent of all excise tax payments. Finally, local governments collected the vast bulk of the most significant wealth-related tax—the property tax. These percentages have not changed much over the years.

What Is a Good Tax?

Our political system, with its three levels of government, has given rise to many diverse taxes, as Table 1 suggests. Some of these taxes are rather unpopular with taxpayers while others appear to have achieved a relatively high degree of acceptance. Thus, for individual taxpayers, some taxes are "good" and some taxes are "bad." Unfortunately, the judgments of taxpayers are not always well founded. Rather, these judgments are often based on self-interest and do not consider the tax system from the point of view of a municipality, a state, or the nation as a whole.

Among the appropriate criteria for evaluating various taxes are political acceptability, equity, neutrality, revenue productivity, and administrative efficiency. Although this list is not intended to be all-inclusive, and different individuals may place more emphasis on one or another of these criteria, those included do reflect the more obvious tax effects and provide a basis for making comparisons among the most important taxes used in the United States. It is worth noting that while tax laws may change, tax rates may change, and revenue needs may change, the criteria for judging whether specific taxes are good or bad *must* remain the same.

POLITICAL ACCEPTABILITY. Taxes are imposed through the legislative process. If taxpayers are displeased by the general level of taxes or the imposition of a given tax, they can vent their dissatisfaction in the voting booth, as Californians have done most demonstratively with Proposition 13. The U.S. Constitution recognizes the need to give taxpayers such a voice. The Founding Fathers specified in the Constitution that all federal tax or revenue bills must originate in the House of Representatives. They felt that this would make Congress sensitive to the thinking of the taxpayer, since representatives must run for re-election every two years.

Congress is quite acutely aware that the sensitivity of taxpayers is a basic political fact of life. In consequence, the passage of legislation that will increase taxes is a slow, painful political process. Tax reductions typically move much faster and are often marked by special treatment for the most vocal groups in society and for those who wield political

TABLE 1
Major Sources of Tax Revenue, by Level of Government, 1975-76

	INCOME TAXES			CONSUMPTION TAXES		WEALTH TAXES			
	PERSONAL	CORPORATE	PAYROLL[a]	SALES	EXCISE	PROPERTY	DEATH AND GIFT	ALL OTHER	TOTAL
	(BILLIONS OF DOLLARS)								
Federal	131.6	41.4	99.9	–	21.7[b]	–	5.2	1.5	301.3
State	21.4	7.3	16.9	27.3	24.4[c]	2.1	1.5	5.1	106.0
Local	3.1	–	–	4.7	2.4	54.9	–	2.1	67.2
Total	156.1	48.7	116.8	32.0	48.5	57.0	6.7	8.7	474.5
	(PERCENTAGES)								
Federal	84.3	85.0	85.5	–	44.7	–	77.6	17.2	63.5
State	13.7	15.0	14.5	85.3	50.3	3.7	22.4	58.6	22.3
Local	2.0	–	–	14.7	4.9	96.3	–	24.1	14.2
Total[d]	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: U.S. Bureau of the Census, *Governmental Finances in 1975–76* (Washington, D.C.: U.S. Government Printing Office, 1977); *Survey of Current Business*, July 1977, pp. 31, 32.

[a] Includes social security taxes paid by employers and employees.

[b] Includes all consumption-related federal taxes, excise taxes, and customs duties.

[c] Includes motor vehicle taxes and operator license fees.

[d] Because of rounding, totals may not add to 100 percent.

power. Consider for a moment the federal surtax imposed in 1968 and the personal income tax rebate of 1975. They were designed to play a stabilizing role in the national economy. The earlier legislation was intended to dampen private spending, and the latter was intended to stimulate private spending. The 1968 bill was passed after fully one and a half years of congressional debate. Its final enactment was considered by many economists as doing too little to dampen private spending and doing it too late. In contrast, the 1975 rebate was proposed and enacted in a matter of months. As might have been predicted, the 1968 increase in taxes was an across-the-board increase of 10 percent. The 1975 reduction consisted of a number of special tax changes benefiting particular groups.

At the federal level, one must look to the committee system in Congress to understand the political processes concerning taxation. The Ways and Means Committee has jurisdiction over taxes in the House; the Senate Finance Committee has jurisdiction in the Senate. Historically these two key committees have been ranked among the most powerful in Congress. They can frustrate other members of Congress and even the executive branch by delaying or killing tax bills in committee. The two committees can gain favor with a variety of special-interest constituencies by approving special tax benefits. Both committees generate significant conflict. Other committees, such as Public Works, are able to minimize conflict because their decisions can be framed so broadly as to allow accommodation among competing interest groups. But there are usually clear winners and clear losers in respect to tax legislation, since powerful interest groups who argue for special benefits tend to cluster around the committees that deal with taxes.

Some taxes can be increased with a minimum of taxpayer resistance, which makes them politically advantageous and expedient to use. These are primarily taxes that can go up without new legislation and that are quite convenient to pay. The federal personal income tax is the prime example. Many have challenged the various "loopholes" in this tax (a topic which will be considered below), but few challenge the tax increases that taxpayers are likely to pay each year. The reason is the progressive rate structure of the tax: it subjects higher incomes to higher marginal rates of taxation. In short, tax liability automatically increases as money income increases.[6]

The convenience in paying arises from the withholding system of collecting personal income taxes. Most individuals pay their federal taxes on personal income automatically through payroll deductions by their employers, and overpayments or underpayments are settled once a year. There is less tax consciousness under this system than if taxpayers themselves had to send monthly checks or sizable annual ones. Thus, the "visibility" of the tax is not nearly as great as it might be. The motives for imposing a system of withholding taxes are not solely political, however. It is much simpler and efficient to collect taxes gradually by a withholding plan than to handle, in once-a-year lump-sum payments, the immense amounts of money due from millions of individual taxpayers.

Retail sales taxes on goods and services—the most important source of tax revenue for state governments—also have an automatic feature. During an inflationary period, the prices of taxable items increase. Since the retail sales tax is a flat percentage of the selling price, tax receipts automatically increase as well. As in the case of the personal income tax, the taxpayers pay their tax liabilities a little at a time except when costly items such as automobiles are bought. Convenience and low visibility usually result in little if any taxpayer resistance.

There is, however, one automatically withheld tax that is no longer ignored by the public. That is the social security tax. The tax rate and the amount of wages to which the rate applies have recently been increased substantially, and more increases are in store. The public is sensitive to abrupt upward moves in these taxes, and for that reason it is possible that scheduled future rises in social security taxes may be moderated (see note 11).

The social security tax has several other features that give it great visibility. For example, it affects virtually all who work for wages and salaries, because people with low incomes are not required to pay any income tax but do pay the social security tax. Moreover, the taxes no longer finance only regular social security benefits. Now they also pay for supplemental benefits to indigent older people and help finance the Medicare program. Although there is some opposition to the regular benefits program, there is considerably more to the other sets of benefits being financed by social security taxes.

Another tax that can go up without new legislation, though it is not convenient to pay, is the tax on corporate profits. Corporations, which pay a flat rate on their income, have been rather acquiescent in the face of the automatic increases in tax payments that result when profits rise. Business profits tend to increase especially fast during inflationary periods, and consequently business tax bills also go up substantially at such times. However, at least a portion of the increased profits resulting from inflation should be devoted to replacing machinery and inventories, whose prices also go up in an inflationary period. Because the tax code does not allow business any tax adjustments designed to replace its assets at rising prices during an inflation, the real financial position of business is undermined.[7] Business leaders are becoming vocal about these effects of the profits tax on corporations.

Businesspeople are quite outspoken about taxes and tax regulations they feel are unwise or unjust. The main taxes they consider unduly burdensome are those on capital gains and for contributions to the social security system. They also consider the regulations allowing deductions from taxable income for depreciation to be unduly restrictive. (Depreciation allowances provide funds with which to replace plants and machinery worn out in the course of production. The latter complaint concerning depreciation treatment is quite separate from complaints of "overtaxation" during inflationary periods.)

In addition to income taxes and the sales tax, there are other taxes that can be imposed with only a relatively mild outcry from taxpayers. These are taxes whose burden or incidence can be shifted to another economic unit, that is, the payer of the tax passes the actual cost on to someone else. For example, it is widely assumed that real estate taxes on rental property are shifted to the occupants. The property owner is the nominal taxpayer, but the owner can increase the rent and thus put part of the real burden on the renter. Taxpayers will attempt to shift a tax to someone else whenever they can. The individual who then ultimately pays the tax—typically in the form of higher prices—often does so unsuspectingly. As a

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[6] There is a great deal of confusion about this. Taxable income is divided into brackets. Higher brackets are subject to higher rates. However, the marginal tax rate is imposed only on income in that bracket. Income in lower brackets is subject to lower marginal rates. For income received in the year 1977, for example, if a married couple filing jointly had more than $3,200 after exemptions and deductions—say, $2,500 more—a tax had to be paid on the $2,500. It was calculated as follows: The first $3,200 of income was not taxable. The first $1,000 above $3,200 was subject to a marginal tax rate of 14 percent. The marginal tax rate on the next $1,000 of taxable income was 15 percent, and the marginal rate on the third $1,000 was 16 percent. The couple's tax liability on their $2,500 of taxable income was $370 (the first $1,000 × 14% = $140; the second $1,000 × 15% = $150; and the last $500 × 16% = $80: $140 + $150 + $80 = $370).

[7] The tax system also is a burden on personal incomes during inflationary periods. Personal incomes tend to rise with inflation. This puts many people into higher tax brackets even though their real buying power has not increased because prices have risen as much as their incomes. Therefore, when the increase in taxes takes effect, their real buying power may easily have declined. It has been proposed that both personal and business tax schedules should be "indexed" against inflation, and it is possible that provision for some sort of indexation will be written into federal tax law, as is now the case in California. Under indexation provisions, the increase in income that occurs because of the effects of inflation is not taxed. Lowering income taxes fairly frequently, as has been the case in the United States during the past decade or so, constitutes an informal system of indexing.

Jam Today and Jam Tomorrow
or
How Much Should Business Be Taxed?

Attitudes toward business taxes—especially on the state and local levels—seem to be in the process of changing. The financial problems of states and municipalities in portions of the Northeast, for example, have partly arisen because high taxation has deterred corporations from building new plants or offices in such places or from expanding existing ones. More visible evidence is the outward move of corporate headquarters or production facilities from the Northeast (New York City has borne many such losses). As a result, local jurisdictions have begun to dismantle the specific taxes or the total tax burdens that seem to have been factors in causing companies to stay away or to relocate.

The nation's tax policy toward business is also coming to be seen as increasingly important. The overwhelming share of national production and of wages and salaries originates in business enterprises, chiefly corporations. Since corporations account for most of the nation's production, if the facilities to create that production are to be expanded and to be kept efficient, corporations need access to enough funds to buy the new machinery and erect the new plants.

Where can those funds come from? Some comes from the money that corporations are allowed to keep in order to replace worn-out plants and machinery (the so-called depreciation allowances). Another important source is the earnings corporations retain after paying taxes and distributing dividends to their stockholders. Both the amount of depreciation and the amount of retained earnings clearly depend greatly on (1) the amount the tax system allows corporations to set aside each year for depreciation and (2) the rate of corporate taxation.

A third important source of funds is the ability of corporations to attract new investments in the stocks and bonds they issue. The level of such investment in part depends on how much savings people accumulate in one form or another, savings that can be invested in such securities. The impact of inheritance taxes on large estates and the rate of taxation on capital gains clearly affect the ability of investors to supply corporations with new investment funds.

Taken as a whole, the effect of taxation on the ability of business to produce depends on the relation of taxation on individuals to taxation on business. If corporations are taxed relatively more heavily than most individuals, consumption of goods and services by individuals will be encouraged. In effect, the output for consumption *today* will be favored over the output of capital goods (plant and machinery). Conversely, if business is taxed relatively lighter than individuals, that will favor more production. The reason is that more money will then be available to buy capital goods, which increase the ability of the economy to produce consumer goods and services as well as to supply jobs *in the future.*

To the economist, many of the battles over tax policy and relative taxation are at bottom battles about consumption today versus consumption tomorrow. Finding a satisfactory balance that will provide for today's consumption and also encourage tomorrow's economic growth is obviously a difficult matter and a source of much argument about the "fairness" and the "balance" of the tax system.

consequence, lawmakers can increase such taxes since many of the taxpayers who actually pay the increase—as in the case of higher rents—usually do not know that their payments have gone up specifically because taxes have been raised.

State governments have been particularly fond of another group of taxes that seems to be easily accepted by the taxpaying public. They are chiefly excise taxes on particular goods or services. Cigarettes, alcoholic beverages, and gasoline are typical of the goods taxed. In recent years states have imposed taxes on winnings from the lotteries or legalized gambling some of these same states sponsor or allow. Taxation of these goods, services, or winnings can be rationalized on moral or ethical grounds. Going further, lawmakers can claim that the increases in such taxes will discourage expenditures on the goods or activities taxed and will also generate revenue for the state treasury.[8]

Concern about the criterion of political acceptability has led to some ill-advised taxation. As state and local governments—and to a lesser extent the federal government—need more revenue to meet their expanding expenditures, they have turned to sources that the economist thinks are either inequitable or inefficient. Some taxing of this kind is done because the unit of government imposing the tax has little or no influence on the decision. This is often true of city and county governments. Under the U.S. Constitution, cities and counties have no inherent authority. They are "creatures of the state government" and thus subject to state control. Hence cities and counties can impose only those taxes their state legislature has authorized. Unfortunately, the taxes authorized by many state legislatures, such as on property and on retail sales, are those of which many economists are critical.

In order to help meet the criterion of political acceptability, the opinions of the public should be part of any consideration of tax legislation. The most obvious way citizens participate is after the fact; they can vote someone out of office because of displeasure over tax policy or they can mandate tax changes through ballot initiatives such as California's Proposition 13 (see adjoining box). But there are other means of political participation, not all of them equally available to everyone. American politics is often termed pluralistic; that is, a large variety of interest groups openly try to influence political deci-

The Origins and Effects of Proposition 13

In June 1978 the voters of California endorsed Proposition 13, which lowered and limited property taxes, and weakened the ability of the state and its localities to increase or levy new taxes. Several factors lay behind this endorsement.

Proposition 13's main thrust, understandably, was against property taxes. Real estate values in California had undergone a tremendous boom. From the middle of 1975 to the middle of 1977, the median price of existing one-family houses shot up from $43,000 to $70,000. Naturally, this gain in the value of property was, at first sight, pleasing. But local property taxes averaged 2.7 percent of current market value. Consequently taxes on the average house rose by $730—from $1,160 to $1,890— an increase of 63 percent!

The rise in the property tax was large, but the ability to pay it had not risen accordingly. The average family's income by no means rose 63 percent in two years. In fact, the income of the average homeowner probably did not even keep up with the pace of inflation, especially after taxes. By 1978, the position of homeowners may well have worsened. A steep increase in social security taxes went into effect in that year, while property taxes continued to rise. Consequently, the average family no doubt found it even harder than before to pay the swelling taxes on their home.

California voters also knew that localities had been forced to resort heavily to the property tax in part because the state had built up a surplus approaching $7 billion from its own tax collections. The voters wanted the state to use the accumulated funds to relieve local tax burdens. Had the state done so before Proposition 13 became an issue, the proposition might not have passed.

An important background factor, it seems likely, was a more or less nationwide feeling that the twin burdens of inflation and taxes were getting much too heavy. Americans may also have had a sense that government mismanagement was rampant—from Washington to state capitals to city halls. And undoubtedly many felt that government spending had in general become too prodigal and the national budget deficit too large. These factors must have affected the vote in California and caused the repercussions of that vote to make taxes a virtually nationwide issue in the congressional, state, and local elections of 1978.

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[8] Note that the regulation and revenue aspects of these types of taxes are in direct conflict. If state legislatures really were interested in discouraging the consumption of these "undesirable" goods and services, the taxes would be high enough to virtually stop consumption. However, then little or no tax receipts would be generated. (Nor would states organize lotteries or encourage gambling in the first place.) Most taxes of this nature have been carefully levied so that the price increase due to the tax is not large enough to discourage consumption significantly. The net result of these types of taxes is that the consumer ends up spending more money for a somewhat smaller amount of the good, and that additional money flows into public coffers.

What happened in California after Proposition 13 went into effect? It had been feared that the first result would be a drastic cut in local services—from police protection to welfare. Cuts there were, but not as deep or as many as anticipated. The effect was partly limited because the state began to distribute its large surplus.

The total tax reduction effected by Proposition 13 was estimated to be $7 billion. About $2.4 billion, or only one-third of the total, went to individual homeowners. Business property taxes were lowered the most—$4 billion, or nearly 60 percent of the total cut. What would business do with the savings: pocket the money, reduce prices, invest more heavily and thus provide more jobs in California—or some combination of the three? How would corporations with a branch in California but whose headquarters were located in other states act? The outcome, of course, will take some years to be definitely assessed.

Landlords gained about $0.6 billion from the tax reduction, and there was much pressure on them to reduce rents accordingly. The majority of landlords apparently did not do so. Accordingly, within six months after Proposition 13 passed, at least six California cities enacted some sort of temporary freeze on rents—in some cases combined with a mandatory pass-through to tenants of 80 percent of the tax savings bestowed by the proposition. And there is a possibility that statewide rent control or tenant rights bills may be passed by the California legislature.

By the passage of Proposition 13, present owners of property have also been put into a position to receive capital gain "windfalls." The reduction in property taxes tends to allow sellers to "capitalize" most of the benefits of the tax cut, that is, they may raise real estate prices by about as much as they think the long-term value of the tax reduction will be worth when they sell the house. The one-time capital gain resulting from such sales will in effect preempt much of the advantage resulting from the lower property tax. Buyers will be paying a higher price—higher by enough, in general, to offset a large part of the tax advantage.

Proposition 13 won't be all gravy to the payers of property taxes in California. If the voters of the state want to keep receiving anything near the current level of services from government, they must sooner or later face higher local or state taxes. Once that big state surplus is spent, funds on the needed scale can probably only be supplied with the help of increased state taxes. (The political by-product would be some shift of political power from localities to the state.) And if the attitude toward property taxes expressed by Proposition 13 effectively spreads across the nation, it may take higher federal income taxes to maintain local services in many parts of the country unless an equivalent amount can be cut out of federal expenditures.

Some additional taxes on income will, in any case, come from California taxpayers as a result of Proposition 13. The income tax payments to both the state and national governments of many homeowners in California are likely to increase. Since California homeowners are now paying lower property taxes, their personal deductions for state and federal income tax purposes will be lower. The smaller the deductions, the higher their federal personal income taxes will be.

There is still a larger question than any yet raised in this account. The passage of Proposition 13 and the reactions elsewhere in the country caused many to think that Proposition 13 was the precursor of attempts to reduce the size of "big government" in the United States, perhaps the beginning of a taxpayer's revolt. Will that actually prove to be the case? Special situations—the extraordinary boom in real estate values and the unusually large state surplus—provided great impetus to the events in California. It will take some time before we learn whether the impact will actually be long-term, nationwide, and major, as was so widely prophesized.

sions. However, not all citizens are members of organized groups, and not all groups have the means or resources to compete effectively. Sometimes tax policy may be inordinately influenced by powerful and well-organized groups comprising only a minority of the population. Hence, the crucial question is often "politically acceptable to whom?"

EQUITY. Equity should be one of the prime criteria in formulating tax legislation, but it is often overlooked. The equity rule generally accepted by economists and political scientists in the United States is that "equals should be taxed equally and unequals should be taxed unequally." The first half of the rule entails what is termed "horizontal" equity; the second half entails "vertical" equity.

The question of vertical equity was implicitly discussed in the introductory pages of this Overview. Many economists contend that a tax must be progressive if it is to conform to the vertical equity rule, that is, the higher the income, the higher should be the tax as a percentage of income.[9]

As Table 1 indicates, the most important source of revenue for the federal government is the personal income tax. Because of its progressive rates, this tax generally conforms to the criterion of vertical equity.[10]

The second most important source of revenue for the federal government is the social security tax, a payroll tax that brings in about twice as much as the tax on corporate income and does not conform to the vertical equity criterion. During 1978, a flat rate of 6.05 percent was paid by the employer and 6.05 percent was paid by the employee on the employee's wage or salary up to a maximum of $17,700.[11]

The social security tax system allows no adjustments for differing ability to pay among various taxpayers. The vertical equity rule is also violated because some taxpayers earn more than the maximum taxable income. In 1978, each dollar earned in excess of $17,700 reduced the "effective" rate of taxation, that is, the tax liability as a percentage of total income. Take the case of an individual who earned $35,400 in 1978. Only the first $17,700 was taxed at the 6.05 rate. Therefore, the effective rate of social security taxation was only 3.025 percent.[12]

It must also be remembered that we are here considering only the tax side of the matter. The regressiveness of the social security tax system is considerably reduced when payments from the Social Security Trust Fund are measured against the past earned income of the recipients. The low-income person receiving social security payments derives greater relative benefits than do others. Moreover, payments to widows and their dependent children as well as other payments made from the Social Security Trust Fund that are *not* related to past earnings also reduce regressiveness. Such payments made up about 50 percent of all expenditures from social security revenues in fiscal 1976.

The most important tax for state governments—the retail sales tax—also tends to be basically regressive relative to current income because low-income families spend a greater percentage of their income on taxable commodities than do higher-income families. This characteristic is intensified in many states, since most exclude services from the tax base. Some states have attempted to make their sales tax less regressive. One method has been to eliminate food, clothing, and medicines from the tax base, because low-income families spend a large percentage of their income on these necessities.

A less direct way to alleviate the regressiveness is to employ an income-tax credit for sales taxes paid.[13] These credits can be tied to the taxpayer's income by decreasing the credit as income increases. For examples, low-income taxpayers—say, below $4,000 of income—might be granted a credit equal to $30 per person in the family. Families with income between $4,000 and $6,000 might be given a credit of $25 per person, while families with income between $6,000 and $8,000 might be given a credit of $20 per person, and so on. At that rate, families with incomes in excess of $14,000 would receive no credit. This type of vanishing credit partially alleviates the regressiveness of a sales tax for those—in this example—with incomes up to $14,000.

The property tax, the most important tax employed by local governments and the third largest revenue producer among all U.S. taxes, also violates the equity rule in the eyes of some economists. (However, as noted earlier, others challenge that view.) Some states have taken steps to eliminate this alleged regressivity. The most effective instrument is, again, an income tax credit—in this case, for property taxes paid. Like credits for sales taxes, these credits are also tied to the taxpayer's income. In addition, a maximum amount of the property tax eligible for the credit is generally stipulated. Maximums vary from state to state but are generally about $500.

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[9] Economists and political scientists have long grappled with the question of vertical equity. Although it is intuitively appealing to assert that progressive taxes are more equitable than proportional or regressive taxes, the assertion cannot yet be strictly proved or disproved. Therefore, the imposition of progressive taxes and the extent of the progression inherent in a given tax remains a question of relative values.

[10] Federal personal income tax rates on "earned" income range from 14 percent to 50 percent. Earned income is basically wages and salaries. The rates go up to 70 percent on "unearned" income, that is, income typically derived from capital investments, such as dividends, interest, rents, and capital gains.

[11] Under the current statute, the maximum income taxable for social security will increase year by year to $29,700 in 1981. Thereafter, the Social Security Administration has estimated, the amount subject to tax will rise to about $38,000 by 1985. The tax rate, by statute, will be 6.13 percent in 1979 and 1980, 6.65 percent in 1981, 6.70 percent in 1982, 1983, and 1984, and 7.05 percent in 1985. These rises are deemed necessary to meet estimated future payments of social security benefits. Proposals have already been made to scale down the large increases now scheduled or to offset their impact by lowering personal income taxes somewhat.

[12] Note that $17,700 × 6.05 percent = $1,070.85 and that $1,070.85/$35,400.00 = 3.025 percent, making the effective rate only half the nominal rate.

[13] A tax credit must be differentiated from a tax deduction. Credits are subtracted directly from the taxpayer's tax liability, while a deduction is subtracted from the taxpayer's tax base. If a taxpayer is granted a $100 tax credit, the tax bill is reduced by $100. However, if the same taxpayer is given a $100 deduction, taxable income falls by $100 and the tax saving is only $100 times the marginal rate of taxation.

Property tax credits are usually set up in the following way. A property owner whose taxable income is 0–$1,000 may credit 75 percent of the property tax bill (maximum $500). If income is between $1,000 and $2,000, the credit is 60 percent. If income is between $2,000 and $3,000, the credit falls to 50 percent. The credit ceases when income rises above $7,000 per year. If an individual has no state personal income tax liability, the tax credit will paid to the taxpayer in the same way as any other tax refund. (Obviously, property tax credits of the foregoing kind can only be employed in states that levy personal income taxes.)

Most states that employ credits for property taxes make provision for renters. In those cases, it is assumed that the burden of the residential property tax is shifted to the renter. Thus, renters may assume that 20 percent of their gross rent up to some maximum, say $500, is passed on from property taxes, and this may be run through a credit system similar to the one described for property owners. Once again, a tax that has traditionally been assumed to be regressive is transformed into a progressive tax—at least at moderate income levels.

We now turn to the criterion of horizontal equity: "Equals should be taxed equally." This criterion is particularly important in terms of taxpayers' good will. If a legal definition of "equals" is employed, most of the major taxes can be given good grades. A legal definition of horizontal equity would stipulate that individuals be treated equally before the law, and that taxpayers should not be subject to arbitrary and capricious treatment. Only one major tax violates this definition of "equals." The culprit is the property tax.

Poor assessments of that tax allegedly violate horizontal equity.[14] The historic problem with property taxes is that similar properties in the same tax jurisdiction are assessed differently, thus violating the horizontal tax criterion. It is a problem that in part explains taxpayer resistance to this tax. Fortunately, new technology is now available to assessors that should improve the quality of the assessment process. In the past, assessments were based on the assessors' best evaluation of the property, and on some occasions on the political influence of vested interest groups in the community. With the aid of computers, an assessor can now draw upon neighborhood characteristics that might affect the value of a particular property. The assessor can average the selling prices of surrounding property, monitor any changes in the composition of home ownership, and trace the number of home improvement loans in the vicinity. In sum, there can now be at the assessor's disposal far more information with which to make a judgment. Consequently, in the relatively near future, even the property tax may conform to the legal criterion of horizontal equity.

But what is really meant by "equals"? Economists are likely to respond that equals are those who are equal in their ability to pay taxes. If this "nonlegal," broad, and admittedly tautological definition of equality is used, only one tax—the personal income tax—can be characterized as intended to adjust for variations in taxpaying capacity. The personal income tax goes beyond assessing progressive rates. It recognizes that income by itself may not truly reflect the ability of taxpayers to pay taxes. Thus, exemptions and deductions have been built into the income tax system. For example, the allowable personal exemption in the federal income tax—$750 for each member of the taxpaying unit in 1977—is an attempt to equalize taxpaying capacity on the basis of family size. Deductions such as medical expenses in excess of 3 percent of gross income and casualty losses in excess of $100 were further meant to reflect taxpaying capacity. Unfortunately, well-meaning attempts to refine taxpaying capacity often open the door to special-interest groups. Thus, even the personal income tax does not earn a grade of "A" on the basis of the horizontal equity criterion, although it scores better than any other major tax used in the United States.

NEUTRALITY. Perhaps politicians are as insensitive to the criterion of neutrality as economists are to the question of political acceptability. At any rate, every major tax is weak with respect to neutrality; that is, every major U.S. tax influences the allocation of resources. Economists assume that, in an efficient market, consumer sovereignty will result in or—more likely—will closely approach an "optimal" allocation of resources. Under such an assumption, any interference that alters the allocation of resources that would occur in a competitive market will result in a loss of economic efficiency. Total production would be less than it could be. Yet, due to the generally recognized need to levy taxes in order to provide for the governing process and to supply certain publicly needed goods and services, some

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[14] Three types of property are subject to property taxation: real, tangible, and intangible. Real property is land and anything attached to land such as a house or a factory. Tangible property is movable property. Tangible is sometimes divided into personal tangible property owned by households, such as furniture, jewelry or works of art, and business tangible property owned by business firms, such as machinery or inventories. Part of the business tangible property tax is sometimes referred to as an inventory tax, since inventories are a highly visible form of business tangibles. Intangible property consists of claims to ownership, such as stocks, bonds, savings accounts, etc. Because of the difficulty of assessing intangible property and some tangible property, many intangibles and tangibles have been excluded from the tax base in a number of states. Thus real property has become the single most important type of property in the tax base.

The Laffer Curve

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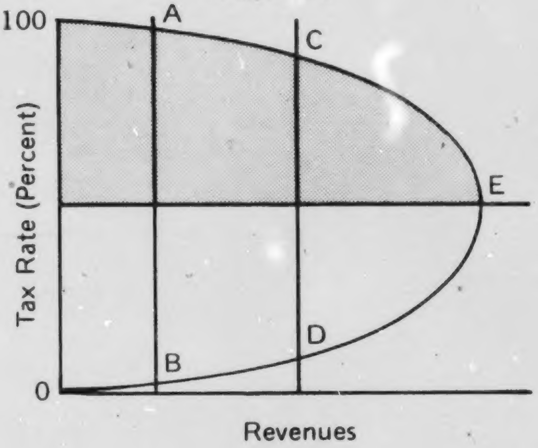
As Arthur Laffer has noted, "There are always two tax rates that yield the same revenues." When an aide to President Gerald Ford asked him once to elaborate, Laffer (who is Professor of Business Economics at the University of Southern California) drew a simple curve . . . [shown here] . . . to illustrate his point. The point, too, is simple enough—though, like so many simple points, it is also powerful in its implications.

When the tax rate is 100 percent, all production ceases in the money economy (as distinct from the barter economy, which exists largely to escape taxation). People will not work in the money economy if all the fruits of their labors are confiscated by the government. And because production ceases, there is nothing for the 100-percent rate to confiscate, so government revenues are zero.

On the other hand, if the tax rate is zero, people can keep 100 percent of what they produce in the money economy. There is no governmental "wedge" between earnings and after-tax income, and thus no governmental barrier to production. Production is therefore maximized, and the output of the money economy is limited only by the desire of workers for leisure. But because the tax rate is zero, government revenues are again zero, and there can be no government. So at a 0-percent tax rate the economy is in a state of anarchy, and at a 100-percent tax rate the economy is functioning entirely through barter.

In between lies the curve. If the government reduces its rate to something less than 100 percent, say to point A, some segment of the barter economy will be able to gain so many efficiencies by being in the money economy that, even with near-confiscatory tax rates, after-tax production would still exceed that of the barter economy. Production will start up, and revenues will flow into the government treasury. By lowering the tax rate, we find an increase in revenues.

The Laffer Curve



On the bottom end of the curve, the same thing is happening. If people feel that they need a minimal government and thus institute a low tax rate, some segment of the economy, finding that the marginal loss of income exceeds the efficiencies gained in the money economy, is shifted into either barter or leisure. But with that tax rate, revenues do flow into the government treasury. This is the situation at point B. Point A represents a very high tax rate and very low production. Point B represents a very low tax rate and very high production. Yet they both yield the same revenue to the government.

The same is true of points C and D. The government finds that by a further lowering of the tax rate, say from point A to point C, revenues increase with the further expansion of output. And by raising the tax rate, say from point B to point D, revenues also increase, by the same amount.

Revenues and production are maximized at point E. If, at point E, the government lowers

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Source: Jude Wanniski, "Taxes, Revenues, and the 'Laffer Curve'." Reprinted with permission of the author from THE PUBLIC INTEREST, No. 50 (Winter 1978), pp. 3–8. © 1978 by National Affairs, Inc.

the tax rate again, output will increase, but revenues will fall. And if, at point E, the tax rate is raised, both output and revenue will decline. The shaded area is *the prohibitive range for government,* where rates are unnecessarily high and can be reduced with gains in *both* output and revenue.

The next important thing to observe is that, except for the 0-percent and 100-percent rates, there are no numbers along the "Laffer curve." Point E is not 50 percent, although it may be, but rather a variable number: *It is the point at which the electorate desires to be taxed.* At points B and D, the electorate desires more government goods and services and is willing—without reducing its productivity—to pay the higher rates consistent with the revenues at point E. And at points A and C, the electorate desires more private goods and services in the money economy, and wishes to pay the lower rates consistent with the revenues at point E. It is the task of the statesman to determine the location of point E, and follow its variations as closely as possible. . . .

For the political leader on the national level, point E can represent a very low or a very high number. When the nation is at war, point E can approach 100 percent. At the siege of Leningrad in World War II, for example, the people of the city produced for 900 days at tax rates approaching 100 percent. Russian soldiers and civilians worked to their physical limits, receiving as "pay" only the barest of rations. Had the citizens of Leningrad not wished to be taxed at that high rate, which was required to hold off the Nazi army, the city would have fallen. . . .

The easiest way for a political leader to determine whether an increase in rates will produce more rather than less revenues is to put the proposition to the electorate. It is not enough for the politician to propose an increase from, say, point B to point D on the curve. He must also specify how the anticipated revenues will be spent. When voters approve a bond issue for schools, highways, or bridges, they are explicitly telling the politician that they are willing to pay the high tax rates required to finance the bonds. In rejecting a bond issue, however, the electorate is not necessarily telling the politician that taxes are already high enough, or that point E (or beyond) has been reached. The only message is that the proposed tax rates are too high a price to pay for the specific goods and services offered by the government. . . .

The idea behind the "Laffer curve" is no doubt as old as civilization, but unfortunately politicians have always had trouble grasping it. . . .

The chief reason politicians and economists throughout history have failed to grasp the idea behind the "Laffer curve" is their confusion of work and productivity. Through both introspection and observation, the politician understands that when tax rates are raised, there is a tendency to work harder and longer to maintain after-tax income. What is not so apparent, because it requires analysis *at the margin,* is this: As taxes are raised, individuals in the system may indeed work harder, but their productivity declines. . . .

. . . In [Adam Smith's] hypothetical pin factory, what is important to a nation is not the effort of individuals but the productivity of *individuals working together.* When the tax rates are raised, the workers themselves may work harder in an effort to maintain their income level. But if the pin-making entrepreneur is a marginal manufacturer, the increased tax rate will cause him to shift into the leisure sphere or into a lower level of economic activity, and the *system* will lose *all* the production of the pin factory. The politician who stands in the midst of this situation may correctly conclude that the increase in tax rates causes people to work harder. But it is not so easy for him to realize that they are now less efficient in their work and are producing less. . . .

The worst mistakes in history are made by political leaders who, instead of realizing that revenues could be gained by lowering tax rates, become alarmed at the fall in revenues that results when citizens seek to escape high tax rates through barter and do-it-yourself labor. Their impulse is to impose taxes that cannot be escaped, the most onerous of which is a poll tax or head tax, which must be paid annually for the mere privilege of living. . . .

loss of efficiency cannot be avoided by society.

The broader shortcomings of the neutrality criterion were considered in the discussion of various tax bases. Numerous more specific violations of tax neutrality have crept into the tax system. The basic difficulty, in part, is that at some point in their history, many societies do not like the composition of output and distribution of income the economic system generates when left to its own devices. As a consequence, society—through tax legislation—interferes with and thereby alters the system. Then the "new" system takes command. Perhaps no example is more striking than the changes in the U.S. economy after the introduction of the personal income tax. The most obvious change stems from the progressive rate structure. That structure plays a large part in determining the composition of the economic output of the United States as well as how it is distributed. Today, in light of all the recent and growing controversy over taxes, the United States may be [illegible] the point where large numbers of people believe [illegible]the system" goes too far in altering the distribution of resources.

A large number of other modifications have been explicitly built into the personal income tax. Many are referred to as "loopholes," and some may be big enough to drive trucks through. But loopholes mean different things to different people. Someone who benefits from a loophole may consider it an inalienable right and never question it, let alone vote to eliminate it.

Some of the "loopholes" that have received much attention in recent years include: lower taxes on income from capital gains than on wages and salaries (designed to make more funds available for business investment); exemption from federal taxation of interest earned on state and local securities (designed to increase the marketability of such obligations); lowering a business's taxes by allowing it to deduct certain expenses from taxable income (designed to allow business to make outlays conducive to maintaining or expanding sales and output).[15]

In addition, there are a number of loopholes in the personal income tax that many taxpayers do not recognize as such. Consider, for example, the deductibility of interest on personal debt and on property taxes paid. The two deductions substantially reduce the cost of home ownership compared to renting residential property. These deductions favor one group, homeowners, over another, renters; and the deductions represent a large leakage from the tax system. Favoritism and leakage are two typical characteristics of tax loopholes. Homeowners, however, do not consider the deductions as privileges, but rather as "equitable tax adjustments." This is a prime example of one taxpayer's equitable adjustment being thought of as a loophole by another taxpayer. These homeowner deductions also violate two tax criteria. In terms of "neutrality," they work to favor owning over renting a home; in terms of "horizontal equity," they treat users of the same type of service—housing—unequally.

The Laffer Curve

CON

. . . the "Laffer curve" that underlies arguments for a family of tax cuts is not the new principle some think it to be; it's a routine expression of basic economic relationships. Yet its use in support of across-the-board tax cuts today is new, and the nature of the support for it is new. . . . what about the Laffer principle? Does it hold up? . . .

Actually, in the right set of circumstances and subject to the right limitations, Laffer's thesis has a lot going for it. We have one real-life example in New York state, where cigarette smuggling is big business, simply because the differential between New York's and North Carolina's taxes is too much to resist. Some estimate that half the cigarettes smoked in New York are smuggled. Clearly, New York would collect more revenue if the rate were sharply lower. . . .

Yet it's one thing to argue that an individual tax is levied at such an onerous rate that widespread avoidance or evasion occurs, and another thing to contend that the total tax structure is high enough to reduce total economic activity to the point where total tax collections are smaller than they would be if tax rates were cut across the board. . . . this thesis is completely unreal vis-a-vis the United States

Source: From "Keynes, Laffer and Jarvis," an address by George W. McKinney, Jr., senior vice president, Irving Trust Company, to the annual convention of the West Virginia Bankers Association, White Sulphur Springs, West Virginia, July 21, 1978. Reprinted by permission.)

Loopholes, or special tax treatments, are not con-today, and . . . it is actually mischievous in that it would be wildly inflationary if it were taken seriously and adopted as the foundation for national economic policy.

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[15] The loophole issue in relation to business expenses concerns the legitimacy of deducting certain kinds of business income for tax-reporting purposes.

Right off the bat, the Laffer model is in error in assuming no output at a 100 percent tax rate. Many economies do tax at or near 100 percent and yet manage to get their people to produce something. Cambodia is one example. It takes brutal oppression to get results, but they do get work effort with near-zero individual monetary incentive.

For another thing, the thesis doesn't stand up to the test of international comparisons. If the United States and other industrialized nations are indeed at the point where high tax rates are reducing the total tax take, then it should be possible, by looking at the ratio of taxes to national output, to spot those nations which have increased their social services and other outlays most rapidly. Not so; growth of government services and the level of taxes [are] almost unrelated.

Similarly, those nations that have large commitments to social benefit outlays should be the ones with the highest standards of living, since only through low tax rates and efficient economies could they collect enough taxes to support their expensive social benefit programs. Again not so; living standards in some welfare states are high while standards in others are quite low. The principal difference is how large a share of the nation's output is available to the citizens versus how much is at the disposition of the state.

One basic problem with the Laffer thesis is that it concentrates on the output side and ignores what happens to nominal incomes when taxes are cut. So it gives a lopsided view of the impact of taxes, and can easily lead to erroneous conclusions if it is used as the basis for policy formation. It's correct in the basic contention that an across-the-board cut in Federal taxes would stimulate private economic activity, but that would be true whether we're on the top part or the bottom part of the Laffer curve.

How fast production would rise is another question, since it would take some time to get the economic machinery moving to produce more. But incomes would start rising immediately. So the initial impact of any tax cut, whether it was sponsored by Laffer or by Lord Keynes himself, would be an increase in nominal after-tax incomes. And the immediate result today would be inflationary. . . .

In the versions of the Laffer thesis I've seen, the immediate impact a tax cut has on nominal after-tax incomes is ignored, and the sequence runs from the tax cut to the increase in investment, to the increase in output, and only then to the increase in incomes. If we're on the upper part of the Laffer curve, as he contends, the effect of a tax cut would be many times larger than if we're on the bottom part. But inevitably there would be that transition period during which the inflation rate would be accelerated. I don't think that, in its present state, the economy could stand to be put through another turn of the inflation wringer on the unlikely supposition that, while no one was noticing, tax rates had moved from the lower to the upper part of that particular curve. . . .

fined to the personal income tax. Taxes such as the excise tax can be designed to interfere explicitly with the allocation of resources. Excellent examples are afforded by the excise taxes in force during the 1940s. Many of them were "luxury" taxes. They fell upon goods and services such as jewelry, luggage, and telephone calls, as well as on airplane, train, and bus tickets. The underlying purpose was to discourage private consumption and make the released resources available for military use during World War II.

Other taxes, such as most general retail sales taxes, inadvertently change the allocation of resources. The most obvious change results from the fact that services are generally excluded. Since the typical sales tax does not cover services, they become relatively cheap compared to the taxable retail goods on the market. Thus another distortion is built into the economic system.[16]

This list goes on and on. Property taxes, for example, also violate the neutrality criterion by increasing the after-tax cost of property improvements. Indeed, some students of urban problems lay part of the blame for urban decay at the feet of the real property tax. The tax base for the real property tax is, of course, land and any improvements (buildings, drainage, driveways, etc.) that are attached to land. If improvements on a particular property are in need of repair, or an additional structure is contemplated, the property owner recognizes that these changes will increase the assessed value of the property and thus increase the owner's tax liability. Property taxes, therefore, act to discourage property improvements. This disincentive has contributed to the decay found in many urban centers that levy high property tax rates.

REVENUE PRODUCTIVITY. It it almost too obvious to note that revenue productivity is a critically important criterion for any tax system. Whether the purpose of the tax is allocative, distributive, stabilizing, or some combination of these goals, substantial tax receipts must be involved if the tax and tax-transfer system as a whole is to meet these goals. (Tax transfers are taxes designed to transfer income from one portion of the population to another. The social security tax, which taxes the young in order to pay benefits to the old, is the prime example.) There are other grounds why governments should not institute or continue unproductive taxes. Such taxes needlessly tie up the time of government employees and put unnecessary strain on the goodwill of taxpayers.

In addition to the absolute number of dollars collected, the tax productivity criterion also raises the fundamental question of revenue elasticity, that is, the relationship between tax receipts and changes in income. The elasticity of tax revenues measures the sensitivity of tax collections to changes in income. If revenue elasticity is high (greater than 1), a small increase or decrease in income will result in a large increase or decrease in tax receipts.[17] If the revenue elasticity is low (less than 1), a large increase or decrease in income will result in a small increase or decrease in tax receipts.[18]

The elasticity of tax revenues is intimately related to the goals of the tax and tax-transfer systems. First, from the perspective of the allocative role of taxes, an elastic tax will ensure future growth in tax receipts; that is, if the demand for government expenditures grows, an elastic tax is needed simply to keep pace. Indeed, from a political point of view, an inelastic tax is a severe liability. A good illlustration is the property tax. It is quite inelastic compared to the personal income tax. Since the tax is relatively insensitive to changes in income while the expenditure demands placed upon local governments keep growing, the only way local governments can generate sufficient revenues is to increase property tax rates. Such increases often prove tantamount to political suicide for the holders of local public office. If the local government could use an elastic tax such as one on personal income, the office holder would not be faced with the grim prospect of levying higher property tax rates virtually every year. The tax base would automatically grow with the growth of overall economic activity in the community, and thus easily generate additional funds.[19]

The government sector can usually obtain increasing revenues from an elastic tax with relative ease. When Ronald Reagan was governor of California, the state for a time took explicit steps to increase the taxpayer's sensitivity to the highly elastic personal income tax. The idea was to increase taxpayer resistance to public expenditure programs in line with Governor Reagan's political philosophy. Although he could not reduce the revenue elasticity of the personal income tax, he did make taxpayers fully aware of their tax liabilities by stopping the withholding of taxes from payrolls. Thus the state income tax came due in a lump sum, thereby greatly raising the taxpayer's awareness of the increase in tax payments.

Revenue elasticity also plays an important role in maintaining economic stability during business cycles. Elastic taxes, such as the personal income tax, are "built-in stabilizers." They automatically withdraw additional funds from the public in times of prosperity and reduce tax payments in times of recession. Thus they temper economic booms and cushion recessions. Other taxes, such as retail sales taxes, are relatively neutral with respect to variations in economic activity. Because these taxes have an elasticity approximately equal to 1, which means that revenues change by the same percentage as incomes, they neither exaggerate nor mitigate business cycles. Of course, inelastic taxes such as the property tax tend to deepen recessions (because collections don't

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[16] Many states exclude most services in the tax base because of political resistance. Certain service industries, such as the legal industry, the medical care industry, and the banking industry are strongly represented in state legislatures. Their powerful position makes it highly unlikely that their "professional services" would be taxed. However, if these services are excluded from the tax base, the door to similar exclusion for other industries that provide services is open.

[17] That is, the percentage change in tax revenues divided by the percentage change in income yields a result *greater* than 1.

[18] In this case, the percentage change in tax receipts divided by the percentage change in income yields a result *less* than 1.

[19] It should be noted that the inelastic nature of the property tax does provide one major advantage to the local taxing authority. During periods of recession, when economic activity and incomes fall, property tax receipts continue to flow into the public sector. Thus, the public sector is not denied the funds needed to support basic public services such as police and fire protection, education, and the provision of basic welfare payments.

*de*crease) and exacerbate booms (because collections don't *in*crease).

ADMINISTRATIVE EFFICIENCY. Even though a particular tax might be given good grades according to the criteria of political acceptability, equity, neutrality, and revenue productivity, it could rate poorly in terms of administrative efficiency. The ability to employ a tax effectively depends upon two factors: the quality of government performance and the level of taxpayer sophistication. If both are high, very complicated taxes can be levied; if one or both are low, only simple forms of taxation can be levied.

Once again the personal income tax provides an excellent example. It is a highly complex tax that can be very effectively administered at the federal level. The administrative ability of the federal government is the product of a well-developed and highly trained staff. But the effectiveness of personnel at the state level is appreciably lower. Before states were given access to information from federal income tax returns, the states' ability to administer state personal income taxes was rather low. As a result, the cost of collection was great, and procedures were poor. Taxpayer sophistication was, of course, the same in both instances—high.

The quality of state tax administration has improved and costs of collection have declined since the early 1960s, when the federal government began sharing tax information. States were thus relieved of the expensive chore of determining and verifying the taxpayer's income as well as whether any adjustments to income were properly allowable.

Logically, the most efficient method of administering a state income tax would be for states to impose a flat percentage rate on the taxpayer's federal income tax liability. However, few states have done so. The reason has to do with state sovereignty. If states simply assess a percentage of the federal tax liability, they are handing control over an important tax to the federal government; that is, if the federal government changes the eligibility for a tax deduction or changes the rates applying to taxable income, the new rules immediately become state law. Thus states that adopt the device must in effect give up some of their constitutional rights. Five states—Alaska, Illinois, Nebraska, Rhode Island, and Vermont—nevertheless follow this procedure. Many other states that have rejected outright acceptance of the federal tax base have redefined their own base to conform more closely with federal definitions.

The degree of administrative efficiency of a tax is enhanced if those subject to it are limited in numbers. The fewer the taxpayers, the fewer the returns to be audited and verified. One example is the federal inheritance tax, which in 1978 did not tax estates of less than $134,000. This amount well exceeds the estate of the average person. A general retail sales tax is also easy to administer for the same reason. Although the taxpayers are many, it is the retail store that collects the money from consumers and pays it over to the city or state. Thus, only the retail stores need to be audited. Indeed, if administrative feasibility were a critical problem for sales taxes, the tax could be levied only on wholesalers or only on manufacturers: reduction to just those few points of collection would markedly lower the cost of collection. It is worth noting that states do not use taxes of this type. Although their costs of collection would be reduced, their own manufacturers or wholesalers would be hurt. Manufacturers and wholesalers outside the state could sell more cheaply inside the state because they would not be subject to the tax.

Perhaps the most difficult tax to administer is the local property tax. Unlike the income tax and the sales tax, which can be collected at extremely low costs (less than 1 percent of the revenues) the property tax is expensive to collect (in excess of 3 percent of the revenues). The problem lies in assessing the value of the property before the tax rate is applied, a difficult and expensive procedure.

So far we have only considered the explicit government cost of collecting a tax. Seemingly, the cost of collecting the federal personal income tax is less than one-half of 1 percent, but this is only the explicit cost borne by the government. There are two other costs: the explicit costs of individuals who must hire accountants or lawyers to prepare their income taxes, and the "implicit" cost of the time spent by individuals who prepare their own returns. Obviously the total real costs to the nation of collecting federal personal income taxes are far in excess of one-half of 1 percent. The explicit and implicit costs of filing corporate income tax returns probably constitute a larger share of the total cost of collecting corporate taxes than do similar costs for personal income taxes. The retail sales tax furnishes another example. The retailer's cost of keeping accurate records for the tax administrator is hidden when only explicit costs are considered.

Conclusion

Taxation in the United States has increased and become much more complex in the last fifty years. An important reason is that more is now demanded of government. To the traditional need for police and fire protection, sanitation services, water supply, education, judicial administration, and the like have been added demands for more interurban and interstate highways, more and better-equipped recreational areas, a cleaner environment, better medical facilities (including those for mental care), special assistance to the aged, and increased help to the poor. These by no means exhaust the list. It has therefore become ever more important for government to spend wisely and to collect revenues in a way that best meets the criteria of wise taxation.

The last fifty years have also been marked by numerous strides toward a sound tax system in the United States, but there is still much room for improvement. If the art of taxation is to continue to be developed, the economist and the political scientist—and ultimately the taxpayer—must learn to evaluate more effectively the implications of any new tax proposal. To do so demands that a consistent set of criteria be used.

It should be obvious that in some cases the basic tax criteria work against one another. A tax that is administratively feasible may not be politically acceptable and vice versa. Further, because of the multiplicity of taxes at the three levels of our federal system, taxes that are neutral when evaluated at one level may in fact be seen to change the allocation of resources when all levels are taken into account.

Public policy can be thought of as those patterns of action by government that are directed at recognized social problems. Political scientists think of public policy as not one action, but as a series of actions having political authority and aimed at some coherent set of social needs. Thus, when we talk of "tax policy," we must talk about the total effect of the entire spectrum of taxes. Too often, however, elected officials, government administrators, and citizens concentrate their energies and attention on one aspect of one tax instead of evaluating the ramifications for the whole tax system. It is obviously impossible to build a tax system that meets every one of the criteria discussed: political acceptability, equity, neutrality, revenue productivity, and administrative efficiency. The best that can be done is to obtain the optimum possible balance between these competing economic and political goals. Achieving this balance is the aim of the fine art of taxation.*

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***Editor's note:** Most readers will have noticed that this overview does not mention, or mentions only in passing, all the taxes or related revenue-raising devices used in the United States. Among the taxes or related devices not analyzed are those on capital gains, estates, inheritances, and gifts; user taxes such as those paid for sewerage systems or water supplies; license fees for vehicles such as cars, trucks, and buses; and tariffs on imported goods. Such levies have been omitted in order to concentrate on the broadest issues in the complex subject of taxation as well as to keep this curriculum unit manageable for classroom use.

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INSTRUCTIONAL ACTIVITIES

JOHN S. MORTON

Why Study Taxes? Rationale and Objectives

Local, state, and federal taxes currently take approximately 35 percent of national income. The total tax bill for a typical American family actually exceeds its expenditure for housing or transportation. Taxes are and will be a fact of life for students. Many of them, however, have a simplistic attitude toward taxes—high taxes are bad and low taxes are good.

The aim of a unit on taxation is to develop more sophisticated and rational thinking on tax policy. Most Americans spend more time computing taxes than making their voices heard in debates about tax legislation. Useful participation requires both clear thinking and sound information.

In order to have the economic understanding to influence tax policy, students must find the answers to questions such as the following: What roles do taxes play in our economy? What are the criteria of a good tax? What effects do various taxes have on economic stability and growth? Who really bears the burden of various taxes? How do different taxes affect income distribution? How does the property tax affect urban problems and equality of educational opportunity? Have special interests influenced tax policy to the detriment of the majority of the American people?

Being able to develop economically sound tax proposals is the first step toward influencing tax policy; having the political know-how to implement these proposals is the equally essential second step. In order to develop the political sophistication needed to hold elected officials accountable for tax legislation, students must first know (a) how tax legislation is written and passed; (b) how citizens can obtain the power to influence tax policy; (c) which political techniques are effective and which are not.

The instructional activities in this unit are designed to help students obtain enough economic and political sophistication to evaluate present taxes and to propose alternatives. Students should have a framework for judging tax proposals and making a choice in light of their own personal values.

Instructional Objectives	Related Instructional Activities
The students should be able to:	
1. List and explain the following roles of taxes: allocative, distributive, stabilizing.	1, 8
2. List and explain the following bases for taxation: income, consumption, wealth.	1, 3, 8

3.	List and explain the following criteria of a good tax: political acceptability, neutrality, revenue productivity, equity, administrative feasibility.	3
4.	Given a list of major taxes in the United States, classify them according to the bases of taxation.	1, 3, 8
5.	Use the criteria of a good tax to evaluate the following taxes: federal personal income tax, social security tax, sales tax, property tax, excise tax, and state lottery tax.	3
6.	Define progressive, proportional, and regressive taxation, and classify taxes into these categories.	2
7.	Defend progressive, proportional, or regressive taxation as the most equitable form of taxation.	2, 8
8.	Distinguish between an effective tax rate and a nominal tax rate.	2
9.	Calculate tax liabilities for a variety of hypothetical taxpayers.	4, 5, 8, 9
10.	Analyze the federal income tax in detail.	9
11.	Examine the economic and political reasons for several of the deductions and exemptions in the federal personal income tax.	9, 10
12.	Explain the operation of the property tax. Assessment procedures, determination of the tax rate, collection of the tax, and penalties for nonpayment should be the minimum considered.	4, 5
13.	Describe the effects of the property tax on urban problems and land use.	7
14.	Analyze the effect of the property tax on the quality of of the public schools.	6, 7
15.	Acting in the role of legislators or as citizens, make decisions involving property tax reforms. This would include: a. Weighing the political acceptability of a tax against the economic criteria of a good tax; b. Resolving conflicts among the various economic criteria of a good tax; c. Showing what political groups would benefit and what groups would be hurt if this property tax reform package became law.	6, 7
16.	Propose ways to make the sales tax less regressive.	2, 8
17.	Describe how a tax bill becomes law.	10
18.	Analyze the limitations of the taxing powers of local governments and how these limitations impinge upon the ability of local governments to govern effectively.	3, 5, 6, 7

NOTE: All the student handouts are reprinted on perforated sheets at the back of this volume.

Instructional Activity 1

WHAT ARE YOUR TAXES?

Recommended Use:	This first activity is designed as the opening exercise of a unit on tax policy.
Time Required:	One 45-minute class period is probably sufficient; student interest and questions could increase the time.
Materials Required:	Visuals A and B. State and local taxes vary; consequently you may wish to alter the list provided on Visual A. Note that Visual B is the same as Table 1 in the Overview.
Rationale:	Most students are unfamiliar with how taxes affect them now and will affect them in the future. This exercise will probably surprise them as they learn that there are many more taxes than they had thought. Students will also see that the myriad of taxes has only three distinct bases: income, consumption, and wealth.
Concepts:	The economic bases of taxation (income, consumption, and wealth); the political reasons for choosing one tax over another; the great number and variety of taxes used in the United States.
Instructional Objectives:	Given a list of taxes, students should be able to: 1. Identify those taxes which raise the most revenue and those which raise the least; 2. Speculate aloud on the reason each tax was legislated; 3. Classify each tax according to the three bases of taxation: income, consumption, and wealth; 4. Describe the economic and political advantages of each of the three bases of taxation.

Teaching Strategy	Pupil Activity
1. Project Visual A or copy it on the chalkboard.	Students probably will be surprised that there are so many taxes.
2. Ask the following questions:	
a. What taxes have you heard of before, and what taxes have you not heard of before?	Students probably will recognize those taxes, such as the income tax, property tax, and sales tax, that are not hidden. They probably will not recognize business taxes or excise taxes.
b. Why do you recognize some taxes and not others? Which of these taxes do you or your families pay directly to the government, and which do you pay indirectly through someone else?	Students should recognize that personal income taxes and residential property taxes are paid directly to the government. Excise taxes are sometimes included in the price of a product. Income, payroll, and property taxes on business are passed on to consumers through higher prices.
c. If you were a holder of political office, what taxes would you impose? Why?	Students should ascertain that it is in the interest of officeholders who want to be re-elected to impose hidden taxes.
d. At this point, bring up the Colbert epigram:	Students will say they don't understand it.

"The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing."	
e. Which taxes raise the most revenue for the national government? State governments? Local governments?	The answers can be found by analyzing Visual B (Table 1 in the Overview).
3. Using Visual B. explain the three bases of taxation: income, consumption, and wealth. Then have students classify each tax on the transparency according to base.	Students should classify the corporate and individual income taxes as based on income; excise and sales taxes as based on consumption; and property, estate, and inheritance taxes as based on wealth.
4. In this initial activity the instructor should probe for some of the general advantages and disadvantages of each tax base. Students should see that the advantages and disadvantages may depend on one's personal perspective. The wealthy may see things differently from the poor. The legislator may view things differently from the taxpayer. The advantages and disadvantages to society may differ from the advantages and disadvantages to any one individual. To explore these issues, ask questions such as these:	
a. What are the advantages and disadvantages of using income as a base of taxation?	Income taxes are the best taxes for allocating the costs of government according to the different characteristics of individuals. (This assumes that those differences are reasonably correctly represented by the differences in people's incomes.) Income tax receipts grow automatically as income increases, but the tax may have the effect of discouraging people from earning additional income. People with high incomes would not like such a tax. Officeholders would be concerned that the tax is not hidden, but would like the fact that tax receipts increase with income. This means that in the future they will have to impose fewer new taxes. In a recession, however, tax receipts may decline although there is then a greater need for government services.
b. What are the advantages and disadvantages of using consumption as a base of taxation?	Some consumption taxes, such as indirect business taxes, are hidden and therefore politically desirable to government officials. Others, such as the sales tax, are visible but paid in frequent, small amounts. This makes them less painful for the taxpayer. Consumption taxes may also force people to reduce their buying, which could start a recession and slow capital formation as well as economic growth.
c. What are the advantages and disadvantages of using wealth as a base of taxation?	Wealth-based taxes encourage consumption and discourage saving. This could cause a reduction in investment and economic growth.
d. Would it be better to rely on one tax or have the present mixture of tax bases?	Students should see that all three bases must be employed for balance and to avoid very high rates on any one base.

NOTE: During this lesson the teacher should explain the basic mechanics of the important taxes. This information is important for later exercises.

Visual A

HERE ARE SOME OF THE TAXES YOU PAY

FEDERAL[a]

Tax	Rate
Income tax	14% to 70% of taxable income
Estate tax	18% to 70% of taxable estate
Social security tax	6.05% of wages up to $17,700 in 1978 on both employer and employee
Corporate income tax	20% to 48% of taxable income
Excise taxes (charged to manufacturer and passed on to consumer)	
Tires (for use on highway)	10 cents per pound (to be reduced to 5 cents on Oct. 1, 1979)
Fishing equipment	10% of manufacturer's cost
Firearms, shells, etc.	10%–11% of manufacturer's cost
Airplane tickets	8% of amount paid on domestic flights; $3.00 on international flights
Diesel fuel & gasoline	4 cents per gallon (to be reduced to 1½% of manufacturer's price on Oct. 1, 1979)
Lubrication oil (for use in highway vehicles)	6 cents per gallon
Telephone and telegrams	4% of amount billed in 1978; then reduced by 1% each year until repeal on Jan. 1, 1982
Alcohol	$10.50 a gallon
Beer	$9 a barrel (31 gallons)
Wine (still)	17 cents to $10.50 per gallon, depending on alcoholic content
Wine (sparkling)	$3.40 per gallon
Wine (carbonated)	$2.40 per gallon
Cigarettes	$4.00 to $8.40 per thousand
Cigars	75 cents to $20 per thousand
Liqueurs, cordials	$1.92 per gallon

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[a] From *Standard Federal Tax Reporter* 1978 index (Commerce Clearing House, Inc. 1978).

Visual A (concluded)

STATE

Types of taxes and rates vary from state to state. Here are some taxes levied by some states:

- Income tax
- Sales tax
- Gasoline
- Alcohol
- Beer
- Cigarettes
- Utilities
- Hotels and motels
- Real estate transfer tax
- Corporate income tax
- Inheritance tax or estate tax
- Auto licenses
- Lottery
- Insurance premiums

LOCAL

Types of taxes and rates vary among local areas. Here are some taxes levied by local governments:

- Property tax
- Earnings and income taxes
- Sales tax (often a percentage of state sales tax)
- Utility tax
- Amusement tax
- Hotels and motels
- Parking
- Auto stickers
- Animal licenses
- Business licenses

Instructional Activity 2

WHAT'S A FAIR TAX?

Recommended Use:	Before beginning this developmental exercise, students should be familiar with the important U.S. taxes and the bases of taxation.
Time Required:	Two 45-minute periods.
Materials Required:	Student Handout 1. The section on political acceptability in the Overview should be useful as teacher background.
Rationale:	Equity is an important criterion of a good tax, and the fairness of a tax may dominate public discussion of that tax. Of course, there is often considerable disagreement about what constitutes fairness. In order to debate this issue rationally and intelligently, it is necessary to comprehend the definitions of regressive, progressive, and proportional taxation.
Concepts:	Progressive, regressive, and proportional taxation; effective tax rate.
Instructional Objectives:	Given a problem sheet on tax equity, students should be able to: 1. Define regressive, proportional, and progressive taxation; 2. Distinguish among taxes that are regressive, progressive, and proportional; 3. Defend a position that one of these three distributional patterns is fairest; 4. Distinguish between an effective tax rate and a nominal tax rate.

Teaching Strategy/Pupil Activity

Since students will be working on the problem sheet, this section concentrates on the information needed to prepare them for the task and on the parts of the sheet where they will have the most difficulty.

Before handing out the problem sheet (Handout 1), discuss the definitions of progressive, proportional, and regressive tax rates. Students will have a difficult time understanding these definitions. They will confuse the income tax base with other tax bases, such as consumption and wealth. For example, they will conclude that the sales tax is a proportional tax since the tax rate is the same for everyone. They will not distinguish between a consumption base and an income base.

Also, spend some time calculating effective tax rates or tax liability as a percentage of income. Students may have difficulty on the computational problems.

These are the answers to the questions on the problem sheet and some discussion points that can be associated with each answer:

1. Proportional
2. Progressive
3. Regressive
4. Regressive. The richer person has double the income but buys only 50 percent more cigarettes. You might point out that many excise taxes are regressive. Of course, excise taxes on luxury goods such as furs and jewelry would not be regressive if most of the people buying these goods were wealthy. Then ask, "Why do we have so many excise taxes?" The answer is that they are politically more acceptable because they are either hidden or paid in such small amounts that taxpayers do not consider the total burden of the tax.
5. Mr. Morales will pay $300, 5 percent of his total income.
   Mr. Burton will pay $450, 3.75 percent of his total income.
   Mr. Morales pays a tax rate of 5 percent.
   Mr. Burton pays a tax rate of 3.75 percent.
   The sales tax is regressive.
6. The sales tax base is consumption, not income. Most states do not include services in their sales tax base. Services such as repair work, haircuts, laundry and dry cleaning, restaurant food, and legal fees are sometimes not included. Since the rich purchase more services, taxing services would make the tax less regressive. It would also raise more revenue. Since the poor pay a greater percentage of their income on food, exempting food also makes the tax less regressive. Several states exempt food from sales taxes.
7. a. 6.05 percent
   b. 6.05 percent.
   c. 3.025 percent.
   d. 1.07 percent.
   e. The social security tax is proportional up to the income ceiling, but after that it becomes regressive.
8. The federal income tax is progressive, with rates on taxable income ranging from 14 percent to 70 percent. Many low-income people pay no tax at all. Deductions, sometimes called "loopholes," make the tax less progressive. In fact, a few wealthy people also pay no tax at all. Excise taxes are almost always regressive since both the poor and the rich buy the taxed products. The property tax traditionally has been considered regressive since a person's expenditure on housing as a percentage of income declines as income increases. It is not as regressive as the unadjusted sales tax and most excise taxes.
9. This is an opinion question that may show the difficulty in determining what is a fair tax. Few students should defend regressive taxation, but opinions should differ on whether progressive or proportional taxation is fairer.

Evaluation: The problem sheet answers provide the basis for evaluation.

Student Handout 1

PROBLEM SHEET—WHAT'S A FAIR TAX?

Almost everyone is concerned about how much we pay in taxes. The best way to determine how much tax you pay is to state your tax as an *effective tax rate*. An effective tax rate is the percentage of your income you pay in taxes. This differs from a *nominal tax rate* or *legal tax rate*. For example, a sales tax rate may be 5% (the nominal rate), but this does not mean that all people pay out 5% of their income in sales taxes. Outlays for rent, insurance, medical bills, among other things, are not subject to sales taxes. Neither, of course, are savings.

Let's look at the effective tax rate of Joanne Walters. If she made $10,000 a year and paid $2,000 in taxes, her effective tax rate would be 20%. You can figure this by dividing $2,000 by $10,000:

$$\frac{\$\ 2{,}000}{\$10{,}000} = 20\%$$

Taxes may have three kinds of effective tax rates. If a tax is *progressive,* the effective tax rate increases as a person's income goes up. For example, a person who makes $10,000 a year may have an effective tax rate of 10% while a person who makes $15,000 a year may have an effective rate of 18%.

If a tax is *proportional,* the effective tax rate stays the same regardless of income. In this case, a person making $10,000 a year and a person making $15,000 a year both would be taxed at an effective rate of 10%. Of course, the person making $15,000 a year would pay more total dollars in taxes.

If a tax is *regressive,* the effective tax rate decreases as income goes up. For example, a person making $10,000 a year might pay an effective tax rate of 10% while a person who makes $15,000 a year might pay an effective tax rate of 8%.

Now answer these questions to see if you understand progressive, proportional, and regressive tax rates.

1. A tax where each person pays 3% regardless of income is a ______________ tax.
2. A tax levied at 1% on the first $1,000 of income, 2% on the next $1,000, 3% on the next $1,000, and so on is a ______________ tax.
3. A tax levied at 15% on the first $1,000 of income, 12% on the next $1,000, 10% on the next $1,000, and so on is a ______________ tax.
4. If it is true that a person with an income of $4,000 a year typically buys six packs of cigarettes per week and a person with an income of $8,000 a year typically buys nine packs of cigarettes per week, this suggests that an excise tax of 10 cents per pack would be a ______________ tax. Explain.
5. Rick Morales has an income of $6,000 and spends it all on taxable goods. Chet Burton has an income of $12,000 but spends only $9,000 on taxable goods. Assuming a 5% sales tax, Mr. Morales will pay $______ in sales taxes which is ______% of his total income. On the other hand, Mr. Burton will pay $______ in sales taxes which is ______% of his total income. Therefore, we can conclude that the sales tax is __________.

Student Handout 1 (concluded)

6. Since the sales tax has the same nominal or legal rate based on sales, why is it regressive? What steps could be taken to make it less regressive?

7. Most people in the United States pay social security taxes. The rate in 1978 was 6.05% on the first $17,700 of income. All income in excess of $17,700 a year was not taxed for social security purposes.

   a. What was the effective social security tax rate in 1978 for a person earning $5,000 a year?

   b. What was the effective social security tax rate for a person earning $17,700 a year?

   c. What was the effective social security tax rate for a person earning $35,400 a year?

   d. What was the effective social security tax rate for a person earning $100,000 a year?

   e. Therefore, we can conclude that the effective social security tax was a ____________ tax.

8. Following is a list of taxes. Indicate in the blank whether the tax is progressive, proportional, or regressive.

   a. Federal individual income tax ____________
   b. Excise tax on liquor ____________
   c. Property tax ____________
   d. Excise tax on gasoline ____________

9. Do you think the fairest tax is progressive, proportional, or regressive? Why?

Instructional Activity 3

WHAT'S A GOOD TAX?

Recommended Use: The beginning of this exercise is developmental while the tax report card is a culminating exercise. Students should be familiar with the various types of taxes and the concept of equity before beginning this exercise.

Time Required: At least two 45-minute periods.

Materials Required: Student Handout 2

Rationale: Students must broaden their conceptions both about the roles of taxation and about the qualities that make a tax "good" or "bad."

Concepts: Roles of taxes (allocative, distributive, and stabilizing); criteria for evaluating taxes (political acceptability, equity, neutrality, revenue productivity, administrative feasibility).

Instructional Objectives: Students should be able to:

1. Discuss the three roles of taxes;
2. Describe the roles of the individual income tax, sales tax, and property tax;
3. List and explain the criteria of a good tax;
4. Evaluate several taxes against the criteria of a good tax.

Teaching Strategy	Pupil Activity
DAY 1	
1. Start the lesson with the question, "Why do we have taxes?"	Students will give a variety of replies, but the most common one will be that we need taxes to raise money for the government.
2. Introduce students to the other roles of taxes. Discuss how increases and decreases in taxes can help to stabilize our economy. Why did Congress and the President lower taxes in 1975?	Students should reason that tax cuts expand economic activity and tax increases contract economic activity. This may be a hard concept for students to understand without further explanation, but it should be mentioned now.
3. Ask students what role a progressive tax plays in our economy.	Since the students have studied tax equity, they should see that progressive taxes help to redistribute after-tax income more equally.
4. Many states have initiated lotteries. Ask: "Why have states chosen lotteries over other taxes? What effects do lotteries have on income distribution?"	The reason for lotteries is to raise revenue (allocation function) without complaints. Therefore, they meet one criterion of a good tax—political acceptability. However, unless people buy lottery tickets in proportion to their income, lotteries are probably regressive.
5. Divide students into groups of three to five. Tell the members of each group that they must come up with a list of three taxes they consider "good" and three they consider "bad." They must justify their decisions. A variation of this exercise is to	The students should report their findings to the class after the group discussions. If they play different roles, develop the theme that one's definition of a good tax differs depending on one's own interests. This has tangible implications for public

have students play different economic roles, for example, consumer, politician, business manager, farmer. Then they should decide what is a good tax from the perspective of their roles.	policy decisions, which must consider all of these diverse interests.
6. When students report their results to the class, try to draw out the criteria of a good tax. For example, ask students who have suggested that the income tax is good or bad why they came to that conclusion.	At this point, students should be developing their own criteria of a good tax.
7. As a summary, list the criteria of a good tax discussed in the Overview. Be sure to point out where students have already come to the same conclusions. The criteria of a good tax are: a. Political acceptability b. Equity c. Neutrality d. Revenue productivity e. Administrative feasibility	Students should be encouraged to ask questions about each one of these criteria in order to bring about better understanding.

DAY 2

1. Distribute Handout 2. Have students read the directions and complete the table.	Students fill out tax report card.
2. Discuss how students graded each tax. Then ask others if they disagree.	Students should defend their answers. There may be differences, particularly in the overall grade.
Ask: "How did you determine your overall grade?"	This question should bring out conflicts as to what criteria of a good tax are most important to students. Since students do not hold elective office, political acceptability may not be too important. Revenue productivity, neutrality, and administrative feasibility are important to economists. Equity usually is the criterion that most concerns the general public.
3. If some taxes receive an overall low mark, ask why those taxes were enacted.	Students should see that hidden taxes such as excise taxes on alcohol and cigarettes are politically acceptable because people do not realize they are paying the tax. The sales tax is politically acceptable because people pay it in small amounts at a time and do not realize the total amount they pay every year. Lotteries are politically acceptable because they turn taxes into a game of chance; this discussion should point out the importance of political acceptability. Also, some taxes, like the property tax, may be the only ones that can raise enough revenue and be administratively feasible for local governments. In fact, in some states the property tax is the only tax that local governments are allowed to use.
4. If one tax is rated high overall, why not use this tax exclusively instead of having so many taxes?	In order to have a balanced tax system, all three bases of taxation should be used. If one base is overutilized relative to the others, disincentives will be introduced into the economic system.

Evaluation: The completed tax report card serves as evaluation.

Student Handout 2

TAX REPORT CARD—"WHAT'S A GOOD TAX?"

Grade each of the taxes below on each of the criteria of a good tax. Then give each tax an overall grade. Be prepared to justify your grades. Use this grading scale:

A = great tax
B = good tax
C = fair tax
D = poor tax
E = horrible tax

Tax	Political Acceptability	Equity	Neutrality	Revenue Productivity	Administrative Feasibility	Overall
Federal individual income tax						
Social security tax						
State sales tax						
Excise taxes (liquor, cigarettes)						
Lottery						
State individual income tax						
Property tax						

Instructional Activity 4

A BRIEF HISTORY OF THE PROPERTY TAX

Recommended Use:	This lesson can be used as an introduction to the study of the property tax. It also develops concepts already studied in the tax unit.
Time Required:	One 45-minute class period.
Materials Required:	Student Handout 3. Summary information should be written on the board or on a transparency.
Rationale:	This lesson describes the original idea behind the property tax and shows how that idea has been changed today.
Concepts:	Property tax, tax rates, wealth as a tax base, assessed value, power and authority of tax assessor.
Instructional Objectives:	After the role-playing activity students should be able to: 1. Describe the general operation of the property tax; 2. Compare and contrast the equity effects of the property tax today with the equity effects on an agrarian economy.

Teaching Strategy	Pupil Activity
1. Distribute Handout 3 and select students to play roles in the skits. Have students play the roles.	Students perform skit 1.
2. Go over the figures in the box, showing that Farmer Big Acres and Farmer Small Acres paid taxes in proportion to their wealth. Ask: "In this situation was the property tax fair?"	Student answers may vary. You cannot tell if the tax is progressive, proportional, or regressive to income. However, one's income probably would be based on land owned. Therefore, the effective tax rate might be proportional.
3. Now have the students act out skit 2.	Students act out skit 2.
4. Ask these questions:	
a. What situations have changed to make the the property tax more unfair?	Today wealth is held in many ways other than land and its improvement.
b. Would it be possible to tax Boss's other wealth?	Students might answer yes, but with further questioning they should see that it would be hard to enforce a tax on stocks and bonds.
c. Is there any other difference between the property tax today and the tax of the nineteenth century when the U.S. economy was mostly agrarian?	Students should recognize that today there is market value and assessed value.
5. Ask if the property tax in skit 2 is more fair or less fair than in skit 1.	It has traditionally been considered less fair since Worker pays a greater percentage of his wealth than Boss.
6. Ask: "Are these skits realistic?"	Students should note that the skits concentrate on extreme cases. The wealth of the middle classes, for example, is more likely to be in the form of houses while the upper classes are more likely to have other personal property such as stocks and bonds.

Student Handout 3

SKITS—HOW THE PROPERTY TAX CAME INTO BEING

SKIT 1: FARMER BIG ACRES AND FARMER SMALL ACRES

Narrator: Once upon a time, there were two farmers who both wanted to finance a school for their community. Let's take our time machine back to see the system they devised.

Farmer Big Acres: Hey, Farmer Small, do you think we should start a school in these parts?

Farmer Small Acres: I sure do—my 13 kids get dumber every day, but I can't afford to pay as much as you.

Farmer Big Acres: We can work that out. We'll tax property. Since I have more land, I'll pay more. Everything will be according to ability to pay. Now, I realize that I have a lot more property than you. Your farm is worth $5,000, and my farm is worth $50,000. Why heck, everyone around these parts says so. Now since what we are worth depends on our land, we'll just tax a percentage of the value of this land. Let's say 4 percent. Now, 4 percent of your $5,000 is $200. Four percent of my $50,000 land value is $2,000. I'm ten times richer in land than you are and will pay ten times more tax.

Farmer Small Acres: That's some pretty fast talking. Could you say that again?

NOTE: At this point the teacher puts the figures on the board:

Farmer Small Acres
Value of land = $5,000
Tax rate 4% ($5,000 x .04 = $200)

Farmer Big Acres
Value of land = $50,000
Tax rate 4% ($50,000 x .04 = $2,000)

Farmer Big's tax is ten times greater than Farmer Small's. The value of Big's property is about ten times higher.

Student Handout 3 (concluded)

SKIT 2: THE PROPERTY TAX TODAY

Narrator: We're at a political rally for the local tax assessor. The tax assessor is the person who determines the value of a person's property.

Worker: I work all my life to buy this dream home, and I can't even afford the taxes. I want a good education for my kids, but I have to eat too. What are you going to do about this oppressive property tax? I pay $900 in property tax!

Tax Assessor: I'm trying to help. After all, the assessment I put on your property is lower than the full value of your house. And we don't assess taxes on your furniture. What do you want me to do?

Boss: You think you've got it bad, Worker? You're lucky to get off for $900. I pay $3,000. It sure doesn't pay to be well off.

Worker: Maybe we can put the comparison in writing. I still think I'm worse off.

	Worker	**Boss**
Value of home	$30,000	$100,000
Value of furniture	7,000	20,000
Value of car(s)	3,000	10,000
Value of stocks and bonds	0	700,000
Total worth	**$40,000**	**$830,000**
Assessed value of car(s) and and furniture	0	0
Assessed value of stocks and bonds	0	0
Assessed value of home (50% of actual worth)	15,000	50,000
Tax rate ($6 per $100 of assessed value)		
$15,000 × .06	900	
$50,000 × .06		3,000

Instructional Activity 5

MEET THE PROPERTY TAX

Recommended Use:	This is a developmental activity. Students should have a general idea of how the property tax works before beginning this unit. Students also should be familiar with the concept of taxes and the criteria of a good tax.
Time Required:	Two or three 45-minute periods
Materials Required:	Student Handouts 4 and 5. The instructor may wish to change the text of Handout 4 to reflect local conditions.
Rationale:	The property tax is the third largest revenue raiser of all taxes in the United States. It is the mainstay of local government revenue systems. It is a tax under attack. As citizens, students may be asked to evaluate proposed reforms of the property tax. Before they can do this, they must understand how the tax works.
Concepts:	Determination of the tax rate, property tax billing, power and authority of tax assessor, power of property owners, political participation.
Instructional Objectives:	After reading an article on the property tax, students should be able to: 1. Determine the relative importance of the property tax compared with other taxes; 2. Describe property tax assessment procedures; 3. Evaluate property tax assessment procedures; 4. Describe the way a property tax assessment can be appealed; 5. Evaluate property tax appeal procedure; 6. Calculate property tax rates from given data; 7. Calculate property tax bills from given data; 8. Describe penalty procedures for the property tax; 9. Evaluate the property tax against the criteria of a good tax.

Teaching Strategy	**Pupil Activity**
DAY 1	
1. Distribute Handout 4.	Students read the article.
2. Ask the following questions:	
a. Why is the assessment of property so important in the administration of the property tax?	Assessment determines the base for tax purposes. Unfair assessment makes the entire property tax unfair.
b. What are some of the problems of assessment?	The technical problem is determining market value. The political problem is keeping people happy.
c. What do we mean by the "market value" of property?	This is the price a willing buyer and a willing seller agree on.

d. Why do assessors often assess property for much less than market value?	This may make it seem that the taxpayer is getting a break. However, lower assessments usually mean higher tax rates.
e. What are some problems of assessing at less than true market value?	Low assessments make it harder for property owners to know whether they are being treated fairly. Property owners find it more difficult to compare the assessment of their property with other properties. In fact, studies have shown that the lower the ratio of assessed value to market value, the less uniform the assessment of property. Property owners usually have a clear idea of the market value of their property.
f. Is the assessor in your area appointed or elected?	The answer will vary.
g. Do you think the assessor should be appointed or elected?	Students may give differing opinions. Elected assessors may be more responsive to the people, but they also may favor persons with political influence over others. Appointed assessors can be more professionally trained and shielded from political pressure by career status. After all, businesses assess property reasonably accurately when deciding whether to buy it.
h. What can you do if you are not satisfied with your property assessment?	You can appeal it. It might pay to have students investigate the appeal procedure in their locality.
i. What are the problems with most appeal procedures?	One often needs political influence. If one goes to the courts, the costs are high.

DAY 2

1. Ask: "How are tax rates determined?"	$\text{Rate} = \frac{\text{budget of local government}}{\text{assessed value of property}}$
2. Distribute Handout 5.	
a. Have students answer Questions 1-4. Then discuss answers.	
b. Have students do Question 5.	
c. Ask: "Why do you think there are so many taxing districts?"	State legislation or the state constitution often mandates a maximum tax rate, and one way to get above that rate ceiling has been to create special tax districts for each government function. Each tax rate can then be less than the maximum, though when added up the combined rates exceed the maximum. Many districts also exist where a number of special activity districts, such as schools, bridges, and parks, cross existing political boundaries.
d. Have the students do Question 6. Discuss each answer, particularly the one to part c.	Students work on problems and discuss answers when finished.
e. Ask: "Why is it important to check the title of a piece of property before buying it?"	The tax follows the property. If you buy property on which tax is still owed, you owe the tax.
f. Ask: "Do you think the property tax is a good tax?"	This is an open-ended question which should provoke a lot of discussion.

Evaluation: Answers to questions on the problem sheet will provide evaluation.

Student Handout 4

MEET THE PROPERTY TAX

One tax that certainly will affect your spendable income is the property tax. If you own a home, you will have to pay property tax. You will even pay the property tax if you rent, since your landlord will obtain the money to pay the tax by including it in your rent.

Basically, the property tax is a tax on land and what is built on the land. Residential, commercial, and industrial property is taxed. Usually the machines and the inventories of goods and materials owned by businesses are also subject to this tax.

The property tax is the most important tax for local governments. Cities, schools, park districts, and counties obtain about 95 percent of their money from the property tax. The tax raises more than $55 billion a year and is the third most important source of tax money in the United States. Only the personal income tax and the social security tax raise more revenue than the property tax.

The property tax also is considered the nation's most unpopular tax. When public opinion pollster Louis Harris asked, "From your personal standpoint, which of these taxes do you feel are too high, which about right?" 68 percent of those interviewed replied that the property tax was too high. This was a larger percentage than was given for any other tax. Some people have even said that Americans are on the verge of a property tax revolt.

But a revolt without facts is folly. How can the property tax be reformed? Can the burden of the property tax be shifted to other taxes? Answers to these questions will make more sense if we know how the property tax really works.

The four steps in property taxation are (1) assessing the value of the property, (2) determining the tax rate, (3) billing each property owner and collecting the tax, and (4) penalizing those who do not pay. We will examine each of these steps.

Step 1—assessing the value of the property. This is usually done by a tax assessor. Some tax assessors are elected and some are appointed. At its best, assessment is only an informed estimate of the market value of the property. The market value is the price a willing buyer and a willing seller would agree upon.

The assessed value of the property is usually lower than the market value. Assessors often are elected public officials. They are more popular politically if they assess property below the market value because voters feel good if, for example, their $40,000 homes are assessed at $15,000. In fact, the election of an assessor may be critical for a local political machine, since the assessor can over- or underassess property for political reasons.

51

Student Handout 4 (continued)

But the real issue is not how low the assessed value of a home is compared to its market value. Rather it is how the assessed value of one home or business property compares with others of equal market value. If a $40,000 home is assessed at $15,000 and a neighbor's identical home is assessed at $10,000, the first homeowner is going to pay more in property tax.

Studies have shown that property in poor neighborhoods is assessed at a higher ratio to market value than property in rich neighborhoods. This is partly because property values tend to increase in rich neighborhoods and tend to decline in poor neighborhoods. Since property is assessed only once every several years, such changes in market value are not promptly reflected on the assessment record books. In this situation the tax may become regressive because the poor pay taxes on a larger percentage of the market value of their property.

If a property owner feels the tax assessor has overassessed the property compared to property of equal market value, the property tax assessment can be appealed. The first step is to contact the assessor's office and try to have the assessment changed. One problem is obtaining enough information to challenge the accuracy of the assessment. An assessor who does not provide adequate information should be suspect.

If the assessor does not take satisfactory action, the ruling can be appealed to a tax appeals board. Its composition will differ from state to state. Some boards are elected and others appointed.

Finally, the property owner can appeal to the courts. The Fourteenth Amendment to the U.S. Constitution guarantees "equal protection of the laws." If some property is assessed higher than other property with equal market value, that property owner is not receiving equal protection under the law. A court appeal, however, costs a lot of money. Appeals may pay off for people with very valuable property, but the court costs outweigh the potential savings for many small property owners. In addition, wealthy taxpayers usually are better informed than lower-income taxpayers and, therefore, more likely to appeal. These conditions make the property tax more regressive.

Step 2—determining the tax rate. All local units of government (schools, counties, cities) submit budgets. The budget is divided by the total assessed value of the government unit in order to determine the rate. Here is an example. A school district has a budget of $2 million, and the total value of assessed property in the district is $200 million.

$$\text{tax rate} = \frac{\$\ 2{,}000{,}000}{\$200{,}000{,}000} = .01$$

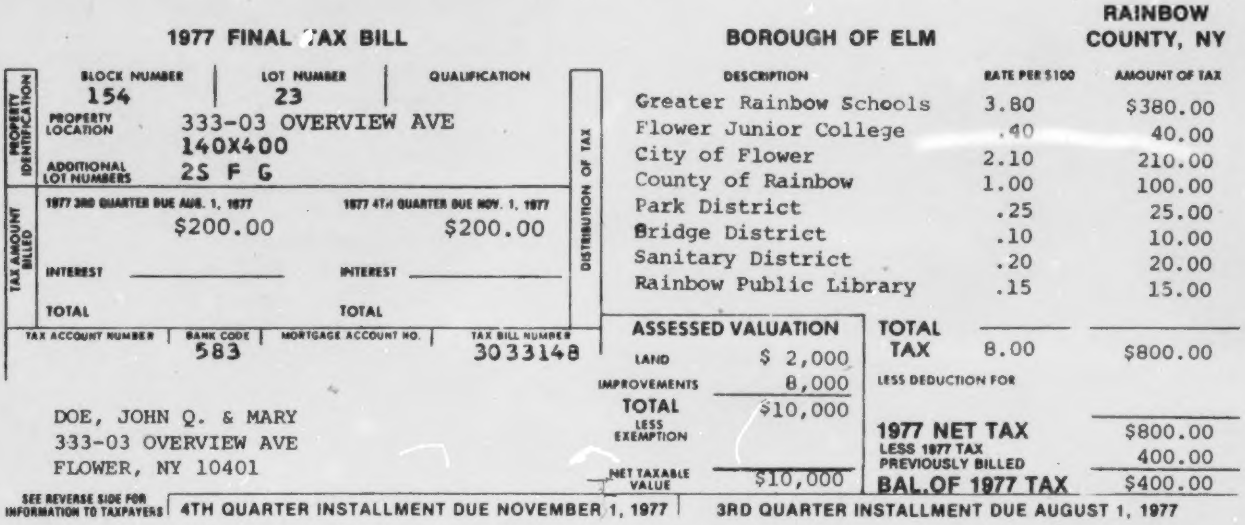
This would be a tax rate of 1 percent, or, as some people say, $1.00 per $100 of assessed valuation.

Why is it important for you to know about this process? Let's say the local assessor cut the assessed value of property in this school district in half. What would happen? The formula would look like this:

$$\frac{\$\ 2{,}000{,}000}{\$100{,}000{,}000} = .02 \text{ or } \$2 \text{ per } \$100 \text{ of assessed valuation}$$

In other words, the rate will double, but the taxes paid would stay the same. The only exception is if the local unit of government is already taxing at a rate

Student Handout 4 (concluded)



1977 FINAL TAX BILL

BOROUGH OF ELM

RAINBOW COUNTY, NY

PROPERTY IDENTIFICATION

BLOCK NUMBER	LOT NUMBER	QUALIFICATION
154	23	

PROPERTY LOCATION 333-03 OVERVIEW AVE
140X400
ADDITIONAL LOT NUMBERS 2S F G

TAX AMOUNT BILLED

1977 3RD QUARTER DUE AUG. 1, 1977	1977 4TH QUARTER DUE NOV. 1, 1977
$200.00	$200.00
INTEREST	INTEREST
TOTAL	TOTAL

TAX ACCOUNT NUMBER	BANK CODE	MORTGAGE ACCOUNT NO.	TAX BILL NUMBER
	583		3033148

DISTRIBUTION OF TAX

DESCRIPTION	RATE PER $100	AMOUNT OF TAX
Greater Rainbow Schools	3.80	$380.00
Flower Junior College	.40	40.00
City of Flower	2.10	210.00
County of Rainbow	1.00	100.00
Park District	.25	25.00
Bridge District	.10	10.00
Sanitary District	.20	20.00
Rainbow Public Library	.15	15.00
TOTAL TAX	8.00	$800.00
LESS DEDUCTION FOR		
1977 NET TAX		$800.00
LESS 1977 TAX PREVIOUSLY BILLED		400.00
BAL.OF 1977 TAX		$400.00

ASSESSED VALUATION

LAND	$ 2,000
IMPROVEMENTS	8,000
TOTAL	$10,000
LESS EXEMPTION	
NET TAXABLE VALUE	$10,000

DOE, JOHN Q. & MARY
333-03 OVERVIEW AVE
FLOWER, NY 10401

SEE REVERSE SIDE FOR INFORMATION TO TAXPAYERS

4TH QUARTER INSTALLMENT DUE NOVEMBER 1, 1977

3RD QUARTER INSTALLMENT DUE AUGUST 1, 1977

that is the legal maximum. If the maximum rate allowed were 1 percent, then the school district would have to get by on less money.

Step 3—billing the property owner and collecting the tax. The tax bill consists of a combination of all the local-government rates. It might look like this:

Can you understand this bill? Each rate was multiplied by the assessed value of the property.

$10,000 × .038 = $380 Schools
10,000 × .004 = 40 Junior college
10,000 × .021 = 210 City
10,000 × .01 = 100 County
10,000 × .0025 = 25 Park district
10,000 × .001 = 10 Bridge district
10,000 × .002 = 20 Sanitary district
10,000 × .0015 = 15 Library

$10,000 × 08 = $800 Total

Notice how important the assessed value of property is. If one property is assessed at a greater percentage of market value than comparable other ones the owner of that property would pay too much tax.

Step 4—penalizing those who do not pay. The taxpayer has a certain length of time to pay the property tax bill. Some places allow installment payments. If the taxpayer does not pay on time, an extra amount or penalty is charged. Eventually, the government can sell the property in order to pay the tax, in which case the property owner loses the property.

The tax follows the property. If an individual buys property on which tax is owed, the new owner, not the former one, is responsible for the tax. That is one reason why people should have the property title searched or should buy title insurance before purchasing property.

Student Handout 5

PROPERTY TAX PROBLEMS—WITH ANSWERS

1. The budget for the Green Valley School District is $3,000,000. The assessed value of the property in the district is $200,000,000. What is the tax rate?

ANS:

$$\frac{\$\ 3{,}000{,}000}{\$200{,}000{,}000} = .015, \text{ or } \$1.50 \text{ per } \$100 \text{ of assessed valuation}$$

2. The budget for Gotham City is $8,000,000. The assessed value of property in Gotham City is $400,000,000. What is the tax rate?

ANS:

$$\frac{\$\ 8{,}000{,}000}{\$400{,}000{,}000} = .02 \text{ of } \$2 \text{ per } \$100 \text{ of assessed valuation}$$

3. What would happen to the tax rate in Gotham City if the assessed value of the property doubled?

ANS:

The tax rate would fall to 1%

4. What is the most effective way for citizens to control the expenditures of local governments?

ANS:

They should go to the budget hearings. They should ordinarily not try to lower the assessed value of the property. The effect would just be to increase the rate unless there were a legal maximum.

5. Calculate the taxes of this property owner.

Assessed Value of Property—$20,000

Rate (per $100 of assessed valuation)	Amount of tax	Taxing Agency
2.00	________	School District #155
0.20	________	Pleasant Ridge Park District
0.02	________	Mosquito Abatement District
0.05	________	Thornton Township
0.10	________	Roads and bridges
1.40	________	Village of New Pittsburgh
1.25	________	County of Calumet
5.02	________	Total

ANS:

The individual taxes can be figured by multiplying $20,000 times each rate. The total tax is $20,000 × .0502 = $1,004.

Student Handout 5 (concluded)

6. Joe Green and Jill Kirkpatrick have identical homes in the same neighborhood. The market value of their homes is \$30,000. Joe's is assessed at 50% of market value and Jill's at 40% of market value. The overall tax rate is \$5 per \$100 of assessed valuation.

a. How much tax does Joe Green pay?

ANS: \$30,000 × .5 × .05 = \$750

b. How much tax does Jill Kirkpatrick pay?

ANS: \$30,000 × .4 × .05 = \$600

c. What are the effective tax rates for Joe and Jill? In other words, what tax do they pay as a percentage of the market value of their homes?

ANS: Joe Green $$\frac{\$750}{\$30{,}000} = .025 \text{ or } 2\tfrac{1}{2}\%$$

Jill Kirkpatrick $$\frac{\$600}{\$30{,}000} = .02 \text{ or } 2\%$$

d. Is this situation fair?

ANS: No. Two people with identical houses are taxed at different rates.

e. Why is assessment so important in the administration of the property tax?

ANS: Unfair assessments result in unfair taxes.

Instructional Activity 6

THE REVOLT OF CALIFORNIA TAXPAYERS

Recommended Use. If there has been a recent local or statewide referendum on property tax relief, you may wish to make that the focus of study rather than California Proposition 13 by substituting information from local newspapers, ballots, etc., for the handouts provided below. The learning activities assume that students have some prior knowledge about the property tax, chiefly the procedures for property tax assessment and the uses governments make of property tax revenues.

Time Required: 2–3 class periods.

Materials Required: Student Handouts 6–10.

Rationale: As citizens, students will be asked to support numerous tax measures, including proposals for tax reform. Responsible action requires an understanding not only of the tax issues involved, but also of the consequences of changes in taxation for individuals and for society as a whole. The recommended learning activities provide opportunities for students to apply their analytic skills to a concrete instance of citizen-initiated tax reform.

Concepts: Political participation, authority, cost-benefit analysis, tax rate, special-interest groups, citizen initiative.

Instructional Objectives:

1. Using the readings provided, students will identify the economic and political factors that contributed to demand for property tax relief by the citizens of California.
2. Given the text and an accompanying analysis of the fiscal effects of the tax relief programs provided by Propositions 8 and 13 voted on in California, June 1978, students will identify and compare the costs and benefits of the programs to different groups of taxpayers.
3. Given a specific voter role as a California taxpayer, students will take a position as to which tax-relief alternatives they will support, based on their assessment of the benefits and costs of the program for the voter as an individual or for the welfare of the community as a whole.
4. Students will identify specific economic and political factors in their own community that have resulted in either an increase or decrease in voter demand for tax reform.

Teaching Strategy

1. Distribute and have students discuss Handout 6.

   NOTE: Most of the following material about the balloting on property taxes in California is presented as if the vote still lay ahead. Actually, Proposition 8 failed and Proposition 13 passed in June 1978.

Pupil Activity

Read and discuss background information, noting specific economic and political factors contributing to the revolt of California taxpayers.

Discussion should include the effects of the following factors on voter attitudes and behavior:

a. number and kind of local and state taxes imposed,

b. property value inflation,

c. the state government surplus,

d. action (or nonaction) on the part of state legislature,

e. provisions of the California Constitution for citizen-initiated referendums,

f. activities of organized taxpayer groups.

2. Distribute Handouts 7 and 8. Explain to students that these were the propositions presented on the June 1978 California ballot. The information provided was available to California voters in the form of a pamphlet from the office of the California Secretary of State.

Read information on Propositions 8 and 13.

3. Through class discussion have students compare the fiscal effects (costs and benefits) predicted for Proposition 8 with those predicted for Proposition 13. Questions for initiating discussion might include:

   a. According to the report of the legislative analyst, what effect would Proposition 8 have on local property tax revenues? Proposition 13?

Students should indicate the following in their comparison of the two propositions:

EFFECTS ON PROPERTY TAX REVENUES

- *Proposition 8* only authorized the legislature to lower the property tax rate for homeowners. It did not require the legislature to do so. Thus, while passage of Proposition 8 could result in a reduction of property tax revenues, it could also result in no change if the legislature chose not to act. Since the proposition did not place a limit on assessment values, an increase in the assessed value of taxable property could also be used to maintain the current level of tax revenue.
- *Proposition 13* required a reduction in the property tax rate and would result in a 57 percent decrease in property tax revenue. It also placed a limit on the extent to which property value assessments could be increased.

   b. What economic effect would each of the propositions have on: Individual homeowners? Apartment and commercial property owners? Nonowners of property, i.e., renters?

EFFECTS ON INDIVIDUALS

- *Proposition 8*, depending upon the action of the legislature, could reduce or leave unchanged the property tax on homes; the rate for other types of taxable property would not be affected. Because the proposition made no specific reference to renters, passage of this proposition alone would not grant them any tax relief.
- *Proposition 13* would result in a 57 percent reduction in the property tax rate on all taxable property (homes, apartment houses, and commercial buildings). Again, no specific mention is made of renters, and no direct tax relief is provided for this group. Any such relief would depend on how much of the property tax savings landlords would voluntarily pass on to tenants.

   c. What other factors cited in the legislative analyst's report or in the arguments for and against the propositions might have influenced voter opinions?

OTHER INFLUENCES ON VOTERS

- Predicted effects on government services, particularly on vital services such as education, police and fire protection, garbage collection, etc.;

- Predicted effects on employment (both government and private);
- Alternative taxes available to local and state government to replace lost property tax revenues and potential effects of those changes on taxpayers;
- Predicted effects on the degree of local control of schools and other community institutions.

4. *Optional*

   a. Inform students that you are going to give each of them a slip of paper describing the role they are to assume as a California voter. Students are to read their assigned voter situation and then decide how they will vote. Possible voting positions include the following (you may wish to write them on the board):

   - Yes on Prop. 8
   - No on Prop. 8
   - Yes on Prop. 13
   - No on Prop. 13
   - Yes on Prop. 8, No on 13
   - No on Prop. 8, Yes on 13
   - No on Prop. 8, No on 13
   - Yes on Prop. 8, Yes on 13

   NOTE: This is basically a forced choice in that some students may—as did some voters in California—choose not to vote. If there appears to be some confusion as to the reason for the last four, more complex positions, have students note that a yes vote on one proposition does not necessarily mean no on the other and vice versa. A no vote on both propositions may be interpreted as showing a preference for the status quo over either of the alternatives offered. A yes on both might be cast by someone who was dissatisfied with the status quo and wanted to be sure that at least *one* of the propositions passed.

   b. Distribute voter role assignments (one for each student) provided in Handout 9. Allow time for thought.

Read role descriptions and, based on consideration of the benefits and costs of the two tax relief programs proposed, decide which of the designated voter positions best serves the student's individual interests.

   c. To record student votes and for future reference draw on the board a table similar to that shown below.

   d. Ask: "How many of you are homeowners?" "How many homeowners voted yes on Proposition 8? No on 8? Yes on 13? No on 13?" Record numbers in the appropriate columns and repeat questions for each voter category.

Respond to questions by a show of hands.

   e. Discuss results of vote with students, noting (1) the extent to which various categories of voters tended (or did not tend) to vote as a bloc, and (2) specific instances where the voting pattern was different from what was expected (e.g., property owners who voted no on 13). Have individual stu-

In the discussion students should:

- State specific factors (potential benefits or costs) that influenced their behavior as voters.
- Note that an individual simultaneously belongs to many groups; consequently, generalizations about how a particular group will vote do not necessarily

GROUP	NO. IN GROUP	VOTER POSITION			
		Yes on 8	No on 8	Yes on 13	No on 13
Homeowners					
Commercial property owners					
Renters					
Government employees					
Private business employees					
Unemployed					

dents state the factors that most influenced their decisions.

5. Distribute Handout 10. To initiate discussion ask:
   a. Which voter groups tended to be most in favor of Proposition 13? What benefits would individuals in these groups gain from the passage of Proposition 13? What would be the costs to persons in these groups?
   b. Which groups tended to be opposed to Proposition 13? Can you suggest any reasons for their opposition?
6. Ask: "Do you think a taxpayers' revolt similar to that which occurred in California could happen here? Why or why not?"

   NOTE: If class discussion reveals lack of student awareness or understanding of local tax issues, this may suggest need for a longer-term assignment involving use of local newspapers and other sources of pertinent data.

predict the voting behavior of each individual in the group.

Read and interpret poll results, (1) noting differences in the voting pattern of various ethnic/racial, income, age groups, etc., and (2) suggesting causes for these differences.

Responses should note similarities and/or differences between the economic and political environment of the local community and that existing in California communities prior to the passage of Proposition 13. Among the economic and political factors students should be attentive to are:

- The number and kinds of taxes imposed by local and state governments;
- Activities (or their lack) of organized citizen groups advocating tax reform;
- Evidence of widespread community support for tax reform;
- Specific tax relief proposals and the potential benefits and costs of these for various voter groups;
- Actions of local and state government that affect tax policy, including how they manage their surplus or deficit positions;
- Political processes available for effecting changes in tax laws.

Student Handout 6

CALIFORNIA TAXPAYERS REVOLT

Background Information[1]

THE INITIATIVE. This is an electoral device through which an individual or group may propose legislation by securing the signatures of the requisite number of qualified voters. The proposition is then placed before the electorate for adoption or rejection. The initiative is called "direct" when filing of the petition is followed by the submission of the proposition to the voters. It is "indirect" when submission is first to the legislature. Then, if that body does not approve, it goes before the voters.

The drafting of measures normally is done by interested groups or their attorneys. The official title and the brief summary that appear on the ballot are the work of the attorney general or some other designated officer. The number of signatures required to qualify a proposition for a place on the ballot is set in the state constitution or laws, either in terms of a percentage of the voters or a flat number. The percentage of voters required to initiate a statute ranges from three to fifteen. Some states require a minimum geographic distribution among those who sign. If a majority of voters vote in favor of an initiated measure, it becomes law. Frequently statutes so adopted have a privileged status and may not be repealed by the legislature.

Political and Economic Environment[2]

In the summer of 1977 Howard A. Jarvis, director of the United Organization of Taxpayers, began his fourth attempt to collect signatures for a petition designed to qualify an initiative on the . . . California ballot that would dramatically lower local property taxes. By November [1977], Jarvis and his organization had collected more than 1.2 million signatures—the largest number ever to support an initiative in California's history—and in June Proposition 13 passed by a 2:1 vote.

For 15 years Jarvis had waged an unsuccessful battle for property tax reduction. . . . why, in 1978, could Jarvis achieve what had previously been impossible? . . .

Three features of the political and economic climate appear critical to understanding Jarvis's success: (1) property value inflation; (2) a legislature that had failed to report out a tax relief bill; and (3) a [$5 billion state government surplus].

California ranks third in per-capita state and local taxes. State and local governments spend nearly $40 billion and employ one out of every 16 California workers. To pay for his [or her] government, a California homeowner is faced with a highly progressive [state] income tax . . . , a 6% sales tax (one of the highest in the nation), and steep property taxes.

[In the years prior to 1978] residential property values . . . increased dramatically throughout California, and particularly in Los Angeles and Orange Counties where more than 40% of the state's voters reside. Homes that cost $50,000 in 1974 often sell for over $100,000 today. As a result of an efficient assessment system, many homeowners' property taxes have doubled and redoubled in recent years.

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1. John H. Ferguson and Dean E. McHenry, *The American System of Government* (New York: McGraw-Hill, 1973), p. 685. © 1973 McGraw-Hill. Used with permission of McGraw-Hill Book Company.
2. From Joan C. Baratz and Jay H. Moskowitz, "Proposition 13: How and Why It Happened," *Phi Delta Kappan*, September 1976, pp. 9–11. © September 1978 Phi Delta Kappa, Inc.

Student Handout 6 (concluded)

. . . Although government expenditures were growing at a rate of 17% per year, with the number of government employees increasing at a 10% rate, the state government still collected more taxes than it spent and accumulated a major surplus. However, despite this surplus, the state legislature for two consecutive sessions was unable to enact a property tax or income tax relief measure from among the 20-odd bills proposed. . . .

While the legislature was unresponsive to the tax burden of its citizens, Jarvis was able to take matters into his own hands because California, like 21 other states, has a procedure allowing citizen-initiated referenda to be placed on the ballot. Using the radio talk shows as a device for raising the issue, Jarvis was able to mobilize support and collect the necessary signatures for his tax relief measure. It was only after the Jarvis proposition qualified for the ballot that the legislature and the governor . . . passed a tax measure of their own. Known as the Behr bill, this tax relief program had to be placed on the ballot because it created separate tax rates for residential and commercial property. [The California Constitution, heretofore, had generally required that all property including homes, apartments, and commercial and industrial buildings, be assessed at the same percentage of market value.] Thus the voters were faced with two tax measures: the Jarvis-Gann, citizen-initiated Proposition 13 and the legislatively enacted Behr bill, Proposition 8. . . .

When there are two tax measures on the ballot, California law requires that, if both pass, a citizen referendum takes precedence and becomes the law. [Advocates of Proposition 13], therefore, had a single task: Get Proposition 13 passed. The foes of Proposition 13 had a more complex job: They had to defeat 13 and pass 8. . . .

64

Student Handout 7

TITLE AND SUMMARY FOR PROPOSITION 8

BALLOT TITLE

OWNER OCCUPIED DWELLINGS—TAX RATE—LEGISLATIVE CONSTITUTIONAL AMENDMENT. Adds Constitution, article XIII, section 9.5, to give Legislature power to provide for taxation of owner occupied dwellings, as defined by Legislature, or any fraction of value thereof, at rate lower than that levied on other property. Tax rate levied on other property cannot be increased as result of lowering rate levied on owner occupied dwellings. Financial impact: Depends on legislative action. Could result in reduction in local revenues.

TEXT FOR PROPOSITION 8

Text of Proposed Law

This amendment proposed by Senate Constitutional Amendment No. 6 (Statutes of 1977, Resolution Chapter 85) expressly adds a section to the Constitution; therefore, provisions proposed to be added are printed in *italic type* to indicate that they are new.

PROPOSED AMENDMENT TO ARTICLE XVIII

Sec. 9.5. *The Legislature may provide for the taxation of owner occupied dwellings as defined by the Legislature, or any fraction of the value thereof, at a rate lower than that levied on other property. In no event may the tax rate levied on other property be increased as a result of lowering the tax rate levied on owner occupied dwellings.*

ANALYSIS BY LEGISLATIVE ANALYST

Background:

The Constitution generally requires all property, including homes, apartments, commercial and industrial buildings, to be assessed for tax purposes at the same percentage of market value.

Generally, all property in the same taxing area is taxed at the same rate.

Proposal:

This proposition would give the Legislature the authority to allow local governments to tax owner-occupied dwellings at lower property tax rates than the rates that apply to all other types of property. The proposition does not say how much lower these tax rates on owner-occupied dwellings could be. However, the proposition prohibits an increase in the tax rates on the other property as a result of lowering the tax rates on owner-occupied dwellings.

Fiscal Effect:

This proposition only authorizes the Legislature to act. It does not require it to do so. Consequently, the proposition, by itself, would have no direct fiscal effect on either state or local government.

If this proposition is approved by the voters and the Legislature acts to permit lower tax rates on owner-occupied dwellings, the net effect on local revenues would be either no change, or a reduction. A reduction would probably occur if there were a big difference between the tax rates on owner-occupied dwellings and the tax rates on all other property.

SOURCE: From ballot pamphlet issued by Secretary of State of the State of California, 1978. Reprinted without editorial changes.

Student Handout 7 (continued)

Argument in Favor of Proposition 8

Your vote for Proposition 8 will make possible honest and lasting homeowner property tax relief.

Our State Constitution now requires all property to be taxed at the same rate. In recent years, home assessments have increased much faster than other property assessments. This has caused you as a homeowner to pay more of the property tax burden.

Proposition 8 ends this injustice by providing "for the taxation of owner-occupied dwellings . . . at a rate lower than that levied on other property." Moreover, this change in the Constitution will not result in an increase in business or agricultural property taxes.

Your yes vote will:

______ Allow the property tax rate on your home to go down as the assessment on your home goes up;

______ Permit removal of burdensome welfare and other costs from your property tax bill;

______ Prohibit a shift of the tax burden to business.

Your vote for Proposition 8 will make possible responsible and lasting property tax relief.

VOTE YES ON PROPOSITION 8

EDMUND G. BROWN JR.
Governor, State of California

VIRGINIA N. STRICKLAND
President, Northpark Square
Homeowners Association

JERRY SMITH
State Senator, 12th District

Argument Against Proposition 8

How do you spell relief?

PROPOSITION 8 spells it M-O-R-E T-A-X-E-S.

How a person could call this law "tax relief" and keep a straight face is beyond me.

It says it's going to lower the tax Rate on some property without raising the tax Rate on other property.

So what? It doesn't say a darn thing about ASSESSMENTS!

What difference does it make if they LOWER your tax rate, if they RAISE your assessment? You still pay higher property taxes!

The only difference is that some people's taxes will go up faster than other people's taxes. Of course, by the time your next property tax bill arrives, the November elections will be over. (How convenient!)

Folks, the supporters of Proposition 8 can explain this thing until they're blue in the face, but it doesn't change the facts. Proposition 8 only confuses the issue. We want LOWER taxes, not merely a different way to RAISE our taxes.

Of course, there are certain groups of taxpayers who will be particularly hard hit by this legislative con game. The worse burden will fall upon renters who pay property taxes indirectly through their monthly rent payments. Since rental property taxes will go up, rents will skyrocket.

If this is tax relief, I don't think we can afford it!

VOTE NO ON PROPOSITION 8.

H. L. "Bill" RICHARDSON
State Senator, 25th District

DAVE STIRLING
Member of the Assembly, 64th District

Rebuttal to Argument in Favor of Proposition 8

So the Governor is going to give us "honest and lasting" property tax relief.

Well friends, if you believe that, we've got some swampland in Florida that you might be interested in buying.

The simple fact of the matter is that Proposition 8 does not lower the property taxes of a single renter or homeowner in the entire State of California. And if it weren't true, we couldn't say it.

Of course, the Governor can say anything he pleases. Take that line about removing "burdensome welfare and other costs from your property

Rebuttal to Argument Against Proposition 8

Here they go again! Every time honest tax relief is put on the ballot, opponents scream "tax increase."

The truth is homeowners and renters won't be hurt by this Proposition. Business won't be hurt, and Agriculture won't be hurt.

BUT MORE IMPORTANT, HOMEOWNERS WILL GET THE PROPERTY TAX RELIEF THEY NEED!

The opponents' argument to this Proposition is just false.

Proposition 8 does do something about assessments, by allowing for the first time, homeowner

Student Handout 7 (concluded)

tax bill," for example. The plain truth is that Proposition 8 does not say a single solitary thing about welfare costs. And if you want to see for yourself, just turn back a page and read the text of the Proposition for yourself.

Frankly, Proposition 8 is nothing more than a last ditch effort by the Governor and the Legislature to keep the people of this State from passing the Jarvis-Gann Initiative (Proposition 13).

We've sat in the Legislature these past two years and heard enough of this gobbledegook. We're voting NO on Proposition 8.

WE URGE YOU TO DO THE SAME

H. L. "Bill" RICHARDSON
State Senator, 25th District

DAVE STIRLING
Member of the Assembly, 64th District

property tax rates to go *down* whenever assessments go up.

Furthermore, the opponents fail to point out that under Proposition 8, reductions in home taxes *cannot* cause increased taxes on rentals, businesses and agriculture.

Tax relief is really spelled P-R-O-P-O-S-I-T-I-O-N 8.

VOTE YES ON PROPOSITION 8

EDMUND G. BROWN, JR.
Governor, State of California

VIRGINIA N. STRICKLAND, PRESIDENT
Northpark Square Homeowners Assn.

JERRY SMITH
State Senator, 12th District

Student Handout 8

TITLE AND SUMMARY FOR PROPOSITION 13

BALLOT TITLE

TAX LIMITATION—INITIATIVE CONSTITUTIONAL AMENDMENT

Limits ad valorem taxes on real property to 1% of value except to pay indebtedness previously approved by voters. Establishes 1975–76 assessed valuation base for property tax purposes. Limits annual increases in value. Provides for reassessment after sale, transfer, or construction. Requires [two-thirds] vote of Legislature to enact any change in state taxes designated to increase revenues. Prohibits imposition by state of new ad valorem, sales, or transaction taxes on real property. Authorizes imposition of special taxes by local governments (except on real property) by [two-thirds] vote of qualified electors. Financial impact: Commencing with fiscal year beginning July 1, 1978, would result in annual losses of local government property tax revenues (approximately $7 billion in 1978–79 fiscal year), reduction in annual state costs (approximately $600 million in 1978–79 fiscal year), and restriction on future ability of local governments to finance capital construction by sale of general obligation bonds.

TEXT FOR PROPOSITION 13

Text of Proposed Law

This initiative measure proposes to add a new Article XIII A to the Constitution: therefore, new provisions proposed to be added are printed in *italic type* to indicate that they are new.

PROPOSED ADDITION OF ARTICLE XIII A

ARTICLE XIII A

Section I. (a) the maximum amount of any ad valorem tax on real property shall not exceed one percent (1%) of the full cash value of such property. The one percent (1%) tax to be collected by the counties and apportioned according to law to the districts within the counties,

(b) The limitation provided for in subdivision (a) shall not apply to ad valorem taxes or special assessments to pay the interest and redemption charges on any indebtedness approved by the voters prior to the time this section becomes effective.

Section 2. (a) The full cash value means the County Assessors valuation of real property as shown on the 1975–76 tax bill under "full cash value," or thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment. All real property not already assessed up to the 1975–76 tax levels may be reassessed to reflect that valuation.

(b) The fair market value base may reflect from year to year the inflationary rate not to exceed two percent (2%) for any given year or reduction as shown in the consumer price index or comparable data for the area under taxing jurisdiction.

SOURCE: From ballot pamphlet issued by Secretary of State of the State of California, 1978. Reprinted without editorial changes.

Section 3. From and after the effective date of this article, any changes in State taxes enacted for the purpose of increasing revenues collected pursuant thereto whether by the increased rates or changes in methods of computation must be imposed by an Act passed by not less than two-thirds of all members elected to each of the two houses of the Legislature, except that no new ad valorem taxes on real property, or sales or transaction taxes on the sales of real property may be imposed.

Section 4. Cities, Counties and special districts, by a two-thirds vote of the qualified electors of such district, may impose special taxes on such district, except ad valorem taxes on real property or a transaction tax or sales tax on the sale of real property within such City, County or special district.

Section 5. This article shall take effect for the tax year beginning on July 1 following the passage of this Amendment except Section 3 which shall become effective upon the passage of this article.

Section 6. If any section, part, clause, or phrase hereof is for any reason held to be invalid or unconstitutional, the remaining sections shall not be affected but will remain in full force and effect.

ANALYSIS BY LEGISLATIVE ANALYST

Background:

The following are some basic facts about California property taxes.

1. Under existing law cities, counties, schools and special districts are permitted to levy local property taxes. During the 1977–78 fiscal year these governments will collect about $10.3 billion in property taxes.

2. The state will give $1.2 billion to local governments to replace the property taxes that cannot be collected because a portion of a business's inventory and a homeowner's property value is exempt from taxation.

3. Total local property tax revenues (tax collections plus state tax relief payments), therefore, will be about $11.5 billion during 1977–78.

4. The share of total income that comes from property tax revenues is higher for some types of local governments than it is for others.
   a. Cities receive about 27 percent of their income from property tax revenues,
   b. Counties receive about 40 percent from property tax revenues,
   c. Schools receive about 47 percent from property tax revenues, and
   d. In many special districts the property tax is the only significant source of revenue. For example, fire districts receive about 90 percent of their income from property tax revenues.

5. In addition to property tax revenues, many local governments impose other taxes and receive federal and state funds to pay for the services they provide. However, some of these revenues can only be used for certain purposes such as transportation, education, health or welfare. Therefore such revenues are not available to replace property taxes, except to the extent they eliminate the need to use property tax revenues for such purposes.

6. The total local property tax roll consists of county assessments on real property (land and buildings) and personal property (inventories) and state assessments on public utilities and railroads. Total assessments are updated periodically to reflect changes in value due to inflation, new construction, and a greater volume of personal property.

7. Total local property tax revenues are equivalent to 2.7 percent of the full cash value of all taxable property in California.

Proposal:

This initiative would: (1) place a limit on the amount of property taxes that could be collected by local governments, (2) restrict the growth in the assessed value of property subject to taxation, (3) require a two-thirds vote of the Legislature to increase state tax revenues, and (4) authorize local governments to impose certain nonproperty taxes if two-thirds of the voters give their approval in a local election.

In several instances the exact meaning of language used in this measure is not clear. Where this occurs we have based our analysis on an opinion of the Legislative Counsel regarding the probable court interpretation of such language.

The following is a summary of the main provisions of this initiative:

1. *Property tax limit.* Beginning with the 1978–79 fiscal year, this measure would limit the amount of property taxes that could be collected

from an owner of county assessed *real* property to 1 percent of the property's full cash value. This measure does not mention county assessed personal property (such as business inventories), or state assessed property (such as public utilities), but the Legislative Counsel advises us that the 1 percent limit would apply to *all* types of taxable property.

This measure does not permit local voters to raise the 1 percent limit; that would require a new constitutional amendment. The limit could be exceeded only to repay bonded debt approved by the voters *before* July 1, 1978. The limit could not be exceeded to repay bonded debt approved by the voters on or *after* July 1, 1978.

Property taxes to repay existing bonded debt correspond to about ¼ of 1 percent of the full cash value of taxable property in California.

The limit on property taxes plus the restrictions on assessed value noted below, would substantially reduce local property tax revenues.

2. *Distribution of remaining property tax revenues.* The reduced property tax revenues which could be raised under the 1 percent limit would be collected by the counties and then distributed "according to law to the districts within the counties."

At present there is no state law which would provide for the distribution of these revenues. Therefore we are unable to determine how the substantial reduction in property tax revenues would be distributed among cities, counties, schools and special districts.

Also, this measure refers only to the distribution of property tax revenues to "districts within the counties." It does not say whether cities and counties (which technically are not "districts") could share in these revenues. However, the Legislative Counsel advises us that unless the ballot arguments by the proponents of this measure, which are included in this pamphlet, make it clear that counties and cities are *not* to receive property taxes, they could continue to receive some portion of these revenues.

3. *Restrictions on the growth in assessed values.* Initially this measure would roll back the current assessed values of real property to the values shown on the 1975–76 assessment roll. However county assessors could adjust the values shown on the 1975–76 assessment roll if these values were lower than the estimated market value as of March 1, 1975. The adjusted values could then be increased by no more than 2 percent per year as long as the same taxpayer continued to own the property. For property which is sold or newly constructed after March 1, 1975, the assessed value would be set at the appraised (or market) value at the time of sale or construction. As a result, two identical properties with the same market value could have different assessed values for tax purposes if one of them has been sold since March 1, 1975.

4. *Increases in state taxes.* Currently state taxes can be increased by a majority vote of both houses of the Legislature and approval by the Governor (that is, if the Governor signs the measure increasing taxes). This initiative would require a two-thirds vote by the Legislature to increase state taxes and would prohibit the Legislature from enacting any new taxes based on the value or sale of property.

5. *Alternative local taxes.* This measure would authorize cities, counties, special districts and school districts to impose unspecified "special" taxes only if they receive approval by two-thirds of the voters. Such taxes could not be based on the value or sale of real property.

The Legislative Counsel advises us that provisions in the existing Constitution would prohibit general law cities, counties, school districts and special districts from imposing new "special taxes" without specific approval by the Legislature. Such restrictions limit the ability of these local governments, even with local voter approval, to replace property tax losses resulting from the adoption of this initiative.

Fiscal Effect

This measure would have the following direct impact on the state and local governments:

1. Local governments would lose about $7 billion in property tax revenues during the 1978–79 fiscal year. This is because the measure would reduce local property tax revenues (estimated at $12.4 billion under current law) by 57 percent, statewide. Some counties would lose more, and others would lose less.

2. The ability of local governments to sell general obligation bonds in the future would be severely restricted. These bonds are used to finance the construction of new schools, local government buildings, and a variety of other facilities such as parks and sewage treatment plants.

3. The reduction in local property taxes would reduce state costs for property tax relief payments by about $600 million in 1978–79.

The full fiscal impact of this initiative would depend on whether or not the $7 billion in local property tax revenue losses were replaced. Replacement revenues could come from two sources:

1. The initiative permits local governments to raise additional revenues by levying other un-

specified taxes. Under existing law, most local governments would have to receive specific approval from the Legislature before levying new taxes. If the initiative is approved, new taxes would also have to be approved by two-thirds of the local voters. Thus the initiative would restrict the ability of local governments to impose new taxes in order to replace the property tax revenue losses.

2. Although there is nothing in the initiative or in current law that would require the state to replace any part of the property tax revenue losses, the state could agree to do so.

If these property tax revenue losses *were substantially replaced,* local governments could maintain the existing level of government services and employment. Part of these revenue losses could be covered *temporarily* by using the state surplus. Additional revenues to pay for these services would have to come from higher state or local taxes such as those imposed on personal income, sales and corporations. Depending upon which tax sources were used to replace local property tax losses, there could be a shift in who initially bears the tax burden. This is because most sales and personal income taxes are paid by nonbusiness taxpayers, whereas about 65 percent of property taxes are initially paid by business firms.

If the $7 billion in local property tax revenue losses *were not substantially replaced* there would be major reductions in services now provided by local governments and in local government employment. We cannot predict which particular local services (such as schools, law enforcement, fire protection, health and welfare) would be affected because we do not know how the remaining property tax revenues would be distributed. Because state law requires local governments to pay for certain local programs at specified levels (for example, unemployment compensation benefits and most local welfare costs), the cuts could not be made in these areas without further action by the Legislature.

The 2 percent limit on assessment increases would not allow property tax revenues to rise as rapidly as prices are expected to increase. This limit would tend to require additional cutbacks in local government services and employment in future years unless additional replacement revenues were available. By requiring that property be reassessed when sold, this initiative would, over time, cause homeowners to pay an increasing proportion of local property taxes because homes are sold more often than other types of property such as commercial and industrial.

If the state surplus is used to cover part of local revenue losses in 1978–79, it would not be available to maintain the level of government services in subsequent years.

In the long run, a major *net* reduction in property tax revenues and local spending could have significant economic effects on the level of personal income and employment in California. Such changes, in turn, eventually would produce unknown additional state and local fiscal effects.

Argument in Favor of Proposition 13

Limits property tax to 1% of market value, requires two-thirds vote of both houses of the legislature to raise any other taxes, limits yearly market value tax raises to 2% per year, and requires all other tax raises to be approved by the people. Why then the amendment? President Carter said "our tax system is a National disgrace".

Our audit figures show loss to local governments at about $5 billion, not $7 billion as claimed by the state finance director.

Assembly leader Paul Priolo said "it's a tough amendment but the state can live with it. It means public officials will have to go to work."

Noted UCLA tax expert Dr. Neil Jacoby writes "This unjust process must be brought to an end". A 1% limit would still leave property tax revenue *far above* the level required to pay for property-related governmental services street lighting maintenance, sewers, trash collection and POLICE AND FIRE PROTECTION."

Argument Against Proposition 13

Proposition 13 invites economic and governmental chaos in California. It will drastically cut police and fire protection and bankrupt schools unless massive new tax burdens are imposed on California taxpayers. It will take decision-making away from the local level and weaken home rule.

Proposition 13 is a vague, poorly drafted and incomplete proposal which will seriously damage the economic stability of state and local governments. Shocking increases in state and local taxes are virtually inevitable. Many homeowners who expect to benefit will actually suffer a net tax increase.

Homeowners will be in for several unpleasant economic surprises if Proposition 13 is adopted. They will be paying higher federal income taxes, yet at the same time the community they live in will lose its rightful share of federal revenue sharing funds. Homeowners living in identical side-by-side houses will pay vastly different property tax bills.

Millions of renters will be doubly jeopardized.

Argument in Favor of Proposition 13 (concluded)

According to the State Controller's office, state agencies will still collect more than 33 thousand million tax dollars every year after this amendment passes. We think this is more than enough. *The people will save 7 thousand million dollars every year* for themselves.

This amendment will make rent reductions probable. Otherwise *rent raises are certain as property taxes go up*. It will help farmers and keep business in California. It will make home and building improvements possible *and create thousands of new jobs*.

To make California taxes FAIR, EQUAL and WITHIN THE ABILITY OF THE TAXPAYERS TO PAY, vote YES on Proposition 13.

HOWARD JARVIS
United Organizations of Taxpayers

PAUL GANN
President Peoples Advocate

The Legislature will not act to reduce your property taxes. As a Senator and Legislator for 11 years, I, like you, have been totally frustrated with the Legislature's failure to enact a meaningful property tax relief and reform bill.

What Ronald Reagan describes as the "spenders coalition" of spendthrift politicians and powerful special interests are spending millions to defeat Proposition 13.

Your Yes vote will NOT require a reduction of vital services like police or fire, nor any tax increase. Your Yes vote will require a tough Governor [to] take the lead in cutting wasteful, unnecessary government spending 10 to 15%.

More than 15% of all governmental spending is wasted! Wasted on huge pensions for politicians which sometimes approach $80,000 per year! Wasted on limousines for elected officials or taxpayer paid junkets. Now we have the opportunity to trade waste for property tax relief!

If we want to permanently cut property taxes about 67% we must do it ourselves. Join Democratic Senator Robert "Bob" Wilson and me, a Republican Senator, in voting Yes on Proposition 13.

JOHN V. BRIGGS
State Senator, 35th District

Rebuttal to Argument in Favor of Proposition 13

PROPOSITION 13:

GIVES nearly two-thirds of the tax relief to BUSINESS, INDUSTRIAL property owners and apartment house LANDLORDS;

Argument Against Proposition 13 (concluded)

Renters have no guarantee that their landlord's property tax savings will be voluntarily passed through to them. But they can be certain they will be forced to pay the new or additional taxes necessary to keep our local governments out of bankruptcy.

Passage of Proposition 13 will slash $7 billion from school and local government budgets—an amount nearly equal to one-half of the General Fund budget for the entire State of California. This crippling blow simply cannot be absorbed. For example, it would require a doubling of your present income tax, or [of] the sales tax to simply replace the lost revenues.

Homeowners and renters are most in need of property tax relief. But Proposition 13 gives two-thirds of the property tax decrease to commercial and industrial property owners.

Proposition 13 will seriously cripple local government services, including police and fire protection. Proposition 13 will force default on many redevelopment and revenue bond issues and prohibit future general obligation bond issues to pay for needed schools, hospitals, and water facilities. Business will not locate or expand in California if the local services necessary for economic development and new jobs are slashed.

This irresponsible initiative is not a solution. Proposition 13 goes too far. It is an invitation to poor community services, less local control and inequitable taxation for all Californians.

Vote "no" on Proposition 13.

HOUSTON I. FLOURNOY
Former State Controller

TOM BRADLEY
Mayor, City of Los Angeles

GARY SIRBU
Chairman, Calif. Common Cause

Rebuttal to Argument Against Proposition 13

We who own homes, farms, property or rent must not let the political horror stories scare us. We must vote Proposition 13 into law June 6, 1978. We must not let the spendthrift politicians continue to tax us

Rebuttal to Argument in Favor of Proposition 13 (concluded)

TRANSFERS your LOCAL CONTROL over neighborhood and community program funding to state and federal government bureaucracies;

PROVIDES absolutely NO TAX RELIEF for RENTERS;

REDUCES drastically police patrol services and fire protection while INCREASING home insurance COSTS by 50% to 300%;

REQUIRES new taxes to preserve CRITICAL SERVICES. Doubling the sales tax, substantially increasing the income tax or increasing the bank and corporation tax by 500% are the potential alternatives;

SLASHES current local funding for PARKS, BEACHES, MUSEUMS, LIBRARIES and PARAMEDIC PROGRAMS;

PENALIZES our school CHILDREN by CUTTING operating school budgets by nearly $4 billion, further lowering the quality of education;

PLACES a disproportionate and unfair tax burden on anyone purchasing a home after July 1, 1978;

INCREASES your state and federal INCOME TAXES and HANDS the IRS nearly $2 BILLION of your tax dollars.

Check the FACTS. Talk to your local officials; talk to your schools and talk to your business and labor organizations and demand to know what cutbacks in essential services would occur if Proposition 13 passes.

JOIN the

LEAGUE OF WOMEN VOTERS

CALIFORNIA TAXPAYERS ASSOCIATION

LOS ANGELES CHAMBER OF COMMERCE

LEAGUE OF CITIES

COUNTY SUPERVISORS ASSOCIATION

CALIFORNIA RETAILERS ASSOCIATION

and countless others who are opposed to this IRRESPONSIBLE MEASURE which CUTS $7 BILLION from critical services.

VOTE NO ON 13!

HOUSTON I. FLOURNOY
Dean, Center for Public Affairs, University of Southern California
Former State Controller

TOM BRADLEY, *Mayor*
City of Los Angeles

GARY SIRBU
State Chairman, California Common Cause

Rebuttal to Argument Against Proposition 13 (concluded)

into poverty. *Proposition 13 will NOT cut fire protection, police protection, sewers, streets, and lighting or garbage collection. All property related services. It will cut spending about 15%.*

Proposition 13 will NOT give business a NEW WINDFALL. It does NOT change the tax ratio between residences and business property in effect for 75 years. It will stop business from leaving California and bring new companies to California, creating thousands of new jobs. Proposition 13 will *NOT* prohibit the use of property taxes to finance schools.

Proposition 13 will make property taxes FAIR, EQUAL and within the *ABILITY to pay for all Californians.*

Proposition 13 will make lower rents certain. It will reduce the monthly impound tax payments on home mortgages.

As expected, the opposition to proposition 13 is signed by 2 persons long on the taxpayers payroll and one person from a tax free foundation. *Proposition 13 makes sense for California. Means thousands of extra dollars for you and your family each and every year. Restores government of, for and by the people.*

Also for 13: Assemblymen Robert Cline (R), Wm. Dannemeyer (R), Mike Antonovich (R), and Senator Bob Wilson (D).

VOTE YES ON PROPOSITION 13, YOUR LAST CHANCE FOR PERMANENT TAX RELIEF.

HOWARD JARVIS, Chairman
United Organizations of Taxpayers

PAUL GANN, President
Peoples' Advocate

JOHN V. BRIGGS
State Senator, 35th District

Student Handout 9

VOTER ROLES

Marital status: Single
Property ownership status: Renter
Occupational group: Private business employee

Marital status: Single
Property ownership status: Renter
Occupational group: Private business employee

Marital status: Single
Property ownership status: Renter
Occupational group: Local school employee

Marital status: Single
Property ownership status: Renter
Occupational group: Unemployed

Marital status: Married (1 school-age child)
Property ownership status: Renter
Occupational group: Homemaker with spouse employed by local government

Marital status: Married
Property ownership status: Renter
Occupational group: You & spouse employed by private business

Marital status: Single
Property ownership status: Renter
Occupational group: Private business employee

Marital status: Single
Property ownership status: Renter
Occupational group: Local government employee

Marital status: Single (widow or widower)
Property ownership status: Renter
Occupational group: Retired

Marital status: Married (2 school-age children)
Property ownership status: Renter
Occupational group: Private business employee

Marital status: Married
Property ownership status: Renter
Occupational group: You & spouse employed by private business

Marital status: Married
Property ownership status: Renter
Occupational group: You & spouse employed by private business

Marital status: Married
Property ownership status: Renter (planning to buy a home)
Occupational group: You & spouse employed by private business

Marital status: Married
Property ownership status: Renter (planning to buy a home)
Occupational group: You & spouse employed by private business

Marital status: Married (3 school-age children)
Property ownership status: Homeowner & owner of business property
Occupational group: Self-employed

Marital status: Married (2 school-age children)
Property ownership status: Homeowner & owner of business property
Occupational group: Self-employed

Marital status:	Married
Property ownership status:	Homeowner
Occupational group:	Employed by construction firm that gets much of its business from government

Marital status:	Married
Property ownership status:	Homeowner
Occupational group:	Private business employee (spouse employed in local schools)

Marital status:	Married
Property ownership status:	Homeowner
Occupational group:	Private business employee

Marital status	Married
Property ownership status:	Homeowner
Occupational group:	Private business employee

Marital status:	Married
Property ownership status:	Renter
Occupational group:	Unemployed (welfare recipient)

Marital status:	Married
Property ownership status:	Homeowner
Occupational group:	Unemployed (spouse employed by private business)

Marital status:	Married (2 school-age children)
Property ownership status:	Homeowner
Occupational group:	Private business employee

Marital status:	Married (2 school-age children)
Property ownership status:	Homeowner
Occupational group:	Private business employee

Marital status: Married (2 school-age children)
Property ownership status: Homeowner
Occupational group: Private business employee

Marital status: Divorced (2 school-age children)
Property ownership status: Homeowner
Occupational group: Government employee

Marital status: Single
Property ownership status: Homeowner
Occupational group: Self-employed

Marital status: Married
Property ownership status: Homeowner
Occupational group: Self-employed

Marital status: Divorced (1 school-age child)
Property ownership status: Renter
Occupational group: Private business employee

Marital status: Single
Property ownership status: Live with parents who are homeowners
Occupational group: Senior in college (will be looking for employment next year)

Student Handout 10

CALIFORNIA VOTER OPINION ON PROPOSITION 13[a]

	Poll Results (percent)		
	Yes	No	Undecided or Unaware
Democrats	50	40	10
Republicans	70	25	5
Others	51	35	14
Homeowners	63	29	8
Renters	42	48	10
Men	60	32	8
Women	53	37	10
White	61	32	7
Black	15	65	20
Latinos	53	34	13
Income groups			
Under $ 7,000	45	37	18
$ 7,000–$ 9,999	46	44	10
10,000– 14,999	53	40	7
15,000– 19,999	54	36	10
20,000– 29,999	63	31	6
30,000 and over	66	31	3
Education			
Less than high school	56	27	17
High school graduate	59	29	12
1–2 years college	59	33	8
3–4 years college	56	35	9
5 years college or more	53	43	4
Age			
18–24	44	50	6
25–29	51	43	6
30–39	51	39	10
40–49	63	29	8
50–59	64	29	7
60+	61	26	13

	Final Vote (number of votes)	
	Yes	No
Proposition 8	2,913,424	3,273,443
Proposition 13	4,188,953	2,281,888

[a] Pre-election poll conducted by the Field Institute, May 29–31, 1978. Used by permission.

Instructional Activity 7

REFORMING THE PROPERTY TAX —A SIMULATION

Recommended Use: This simulation is a culminating activity. Students should be familiar with the operation of the property tax and its strengths and weaknesses.

Time Required: At least four 45-minute periods; probably one week.

Materials Required: Student Handouts 11-17. These are the six testimony sheets needed for the simulation. In order to help the special-interest groups prepare their testimony, teachers should have considerable background in property taxation. Some informative publications are Aaron (1975), Ecker-Rasz (1970), and Peterson (1973) as well as *Property Taxation in Government Finance,* which was published by the Tax Foundation in 1974; details are given in the Bibliography at the end of the Topic Overview.

Rationale: The property tax has been criticized as one of the worst of all taxes, but it remains the mainstay of local government finance. It is a giant step to move from complaining about the tax to making constructive reforms. Property tax reform goes to the heart of social philosophy concerning the kinds of cities, education, and public services people desire. This simulation should bring perspective to these vital areas.

Concepts: Property tax reform, site value taxation, tax incidence, tax equity, political bargaining, policy decisions, circuit-breakers.

Instructional Objectives: After participating in this property tax reform bill simulation, students should be able to:

1. Recognize the issues in property tax reform;
2. Recognize the difficulties in making tax policy decisions;
3. Evaluate the arguments for and against proposals for changes in the property tax such as site value taxation, circuit-breakers, tax exemptions, and statewide educational financing;
4. Predict the reaction of special-interest groups to property tax reform proposals.

Teaching Strategy/Pupil Activity

Since the students will be simulating, this section will consist of a teacher instruction guide for conducting the simulation.

Step 1: Organize the students into seven groups as follows: Have two or three students represent each of the six special-interest groups. Try to have a mixture of higher and lower ability students in each group. The testimony of the "Save Our Cities Coalition" is particularly complex, and some students with high ability should be selected for this group. The seventh group—the remainder of the class—will be members of the House Finance Committee of a state legislature.

Step 2: Pass out the testimony sheets and Finance Committee instruction sheet. Be sure to tell the members of the special-interest groups to prepare the testimony in their own words. Since they will be questioned by members of the committee, they must understand the strengths and weaknesses of their position thoroughly.

The members of the Finance Committee must be urged to question those giving the testimony until they understand the position. This is essential if the issues are to be aired and understood completely.

Step 3: Help the special-interest groups prepare their testimony. Be sure to bring out some arguments against their position so that they will know how to defend it. An evaluation of each position as seen by experts on taxation follows Step 8 of these instructions. The evaluations are not meant to be comprehensive. They concentrate on the arguments *against* each position since the arguments *for* each position are in the testimony sheets.

Step 4: The special-interest groups deliver testimony before the committee. Be sure to encourage questions so that everyone understands the issues.

Step 5: The committee writes the tax bill. The members of the special-interest groups should observe the deliberations. Their task is to describe the committee deliberations later. Each student should answer questions such as these:

1. Which arguments did the committee find most persuasive? Least persuasive?
2. Which people had the most influence on the committee? Why?
3. What political techniques were used by committee members to influence others to adopt their position?
4. To what degree did the committee consider the economic implications of their task? To what degree did they consider the political implications?

Step 6: The committee reports its bill to the public (special-interest groups). Each special-interest group must critique the bill according to how well the committee satisfied its interest. The committee must defend its bill and point out how the bill is in the general public interest. The teacher should make sure the issues in property tax reform are brought out.

Step 7: By secret ballot class members first vote to accept or reject the bill on the basis of their role-playing status. Then they vote again on the bill on the basis of their own personal position.

Step 8: Review the simulation. One way to do this is to compare the committee's bill with the criteria of a good tax. Ask how important political considerations were compared to economic considerations. Go over the students' observations of the committee's work. Finally, relate the simulation to the real world. In what ways was the simulation realistic? In what way was it unrealistic?

Evaluation and Teacher Background Information for Step 3

Special-interest groups should be evaluated on the strength of their testimony. The committee bill should be evaluated against the criteria of a good tax. Grades could also be given for active participation to encourage participation.

"Save Our Cities Coalition" Testimony

Site value taxation is a revival of parts of the single-tax idea of Henry George. Many economists, city planners, and urban specialists are advocating site value taxation as a way of limiting land speculation so that cities can rebuild without sprawl.

But there are problems. Taxing land rather than improvements is practiced on a limited scale in Pennsylvania and Hawaii. Researchers have found little evidence that it stimulated property improvements. However, the tax difference between land and buildings averages only about 10 percent in those states. Moreover, other studies have shown that property improvements in the city frequently are not reassessed. Interviews with investors indicate that fear of reassessment plays a minor role in the decision whether or not to improve property.

Environmentalists fear that site value taxation would encourage construction of more high-rise buildings for business and residential purposes. That would increase population density and could well cause air, water, and noise pollution problems.

There also would be a problem in administering the tax. How can the value of the land be separated from the value of the improvements?

Finally, site value taxation can create political problems. Assume that the tax assessment procedure in a community with good public services is switched to place a higher burden on land, while the burden on the houses remains the same. If the land and the houses are about equal in market value, the total assessment for less expensive houses would then go up. If the assessment on the land is raised proportionately more than the reduction in the assessment on the houses, an owner might have to pay more taxes than before or very little less, depending on the exact changes in assessments. In contrast, the total assessment for more expensive houses might go down because the value of the houses could be appreciably greater than the value of the land. In this case, the higher tax due on the land compared with the houses might result in an owner's paying noticeably less taxes than before, with the actual change again depending on the exact changes in assessments.

"Farmers United" Testimony

Several states already direct tax assessors to value farm land on the basis of current use rather than current value. However, these provisions may help real estate speculators more than farmers. Speculators can use farming as a cloak to save taxes while holding the land for appreciation. This policy also may promote the urban sprawl that the advocates of site value taxation fear.

"The Business Owners Coalition for a Better America" Testimony

Favorable tax treatment of businesses in one locality may start a tax exemption war with other localities that want to keep their present business enterprises or attract new ones. In the end, such a "war" may result in little if any gain for the localities involved.

Businesses also are users of public services. A firm may be able to attract more employees if its location has good educational and recreational facilities. Its ability to expand production may depend on the availability of water and sewage disposal services. Its capability to serve customers may depend on improved roads. A community that offers such advantages is not likely to be able to give business much if any favorable tax treatment.

Studies also show that property taxes do not influence decisions on business location nearly as much as some people imagine.

"Homeowners Improvement Association" Testimony

The American homeowner may have reached the revered status of motherhood and apple pie. Many states already assess *owner-occupied single-family dwellings* at a lower percentage of market value than other property. But taxing rental, commercial, and industrial property at a higher rate has serious drawbacks. The property taxes on rental property are at least partially shifted to the renters. Since on the average renters have lower incomes than homeowners, higher assessments on rental property than on single-family homes result in a more regressive tax. Property taxes on commercial and industrial property are also shifted to consumers, at least partially, in the form of higher prices. The shifting incidence of a tax is an important concept for students to understand.

"Senior Citizens Action Program" Testimony

Many states now have circuit-breaker laws to aid low-income senior citizens. According to economist Henry Aaron, "The typical existing circuit-breaker covers only the aged, aids renters as well as homeowners, limits benefits to households with incomes below $5,000 or $6,000, but contains no asset test and imposes a maximum on total relief of $500 or less" (*Property Tax Reform*, p. 54). Aaron is critical of the circuit-breaker movement. He fears that since one major criticism of the property tax is its effect on the aged and low-income people, circuit-breaker laws will encourage putting a greater burden of property taxes on others.

Furthermore, many of the neediest citizens with incomes modestly above the eligibility level for property tax relief will receive no help at all while those with substantial wealth could receive aid. This might happen because the latter receive little income but have many assets such as land and jewelry that they can sell.

Many people foresee the extension of circuit-breakers to all low-income people. Of course, the revenue loss must be replaced to maintain public services.

"Citizens for Equal Educational Opportunity" Testimony

The effect of the property tax on equality of educational opportunity is controversial. For example, the supreme courts of California, Michigan, and New Jersey have ruled the property tax unconstitutional for financing education. The California Supreme Court in *Serrano* v. *Priest* stated: "We have determined that [the California] funding scheme invidiously discriminates against the poor because it makes the quality of a child's education a function of the wealth of his parents and neighbors."

NOTE: The teacher might ask the students to ascertain the legal status of local property taxes in relation to the financing of local school systems in their own state.

Student Handout 11

"SAVE OUR CITIES COALITION" TESTIMONY

As you know, the cities are in grave trouble. Some say that the cities are dying. If they die, the property tax will be one of the things that killed them.

Local governments rely on the property tax for some 80 percent of their tax revenues. The property tax is not one tax; it is two. Part of the tax is on land value, and part of the tax is on the improvements placed on the land. It would be hard to imagine a tax whose consequences for urban renewal and urban development would be more contradictory.

The owners of land often do little or nothing to increase its value. In fact, it is taxpayer money that improves the area and makes it more valuable. It was tax money that paid for the roads, schools, water systems, mass transit facilities, parks, and police and fire protection that made the land easy to get to, pleasant to live or work in, and salable at a good price. Why should the private owner of land obtain most of the benefits through renting or selling? Tax the land heavily so that the revenue obtained from public facilities goes to the public treasury.

The other part of the property tax, the tax on improvements, has the effect of discouraging efforts to improve the land. We need to encourage private enterprise to rebuild our cities, but the tax on improvements in fact discourages this. If an owner invests in the property, that is, spends money to improve it, the value of the property increases, and the tax on that property also increases. On the one hand, investors who improve the land and thus enhance the environment and quality of life in the cities face increased taxes as a result. The same is true of industrial improvements that create more jobs for city residents. On the other hand, slum landlords who let their buildings deteriorate are rewarded by lower property taxes. Lowering the tax on property improvements will encourage owners to improve their land as well as put it to the best possible use. At the same time, slum landlords will reap smaller tax decreases relative to those other people pay if improvement taxes are low.

Taxing land itself heavily will discourage land speculation. Low taxes encourage owners to hold land until the price skyrockets. When urban building sites and land on the urban fringe are held off the market, builders are encouraged to build houses in the countryside. This clustering of residential sites outside the city limits provides an incentive for industry to follow and go where the people are. The tax base of the city is reduced by the outward move of both people and businesses. The resulting "suburban sprawl" increases the cost of water distribution, sewage collection, transportation, and police and fire protection. All these costs are paid by the taxpayers while the speculators in suburban land make substantial profits. Worse yet, the city may deteriorate and become slum-ridden because of the moves away from it.

The first step toward taxing land more and improvements less is to exempt property improvements from taxation for a number of years. For example, let's assume an apartment owner is getting as much rent as the condition of the rental market in the area permits. The owner considers adding air conditioning to the apartment. If the improvement is exempted from taxation for five years, the owner will be encouraged to install the air conditioner and will be able to raise rents somewhat. Encouraging landlords to upgrade their property will help improve the quality of life in the community.

Therefore, we urge you to pass a state law taxing land more heavily and taxing improvements less.

Student Handout 12

"FARMERS UNITED" TESTIMONY

We come to this committee today with an urgent plea to save the way of life of the American farmer. The farms around our cities are disappearing. Ticky-tacky houses are replacing the fresh vegetable gardens and fields of wheat that used to sway gently in the wind. Soon the people of the city will not even be able to show their children a cow or a horse on a Sunday afternoon drive.

What is responsible for closing this admirable chapter of our American traditions? The culprit is the property tax. Urban and suburban sprawl has made farm land on the fringes of our cities valuable for speculators. For this reason, tax assessors often double and triple the assessed value of our land. This assessment would be fine if there were houses and stores on this land. But it is farm land, and the property taxes are too high to be supported by farm operations. Thus, our land has become too valuable to farm.

But we want to farm. It is the only life we know. You can help us to continue farming by passing a law requiring farm land to be assessed on the basis of current *use* rather than current *value.* If you let us pay the same taxes as are imposed on equivalent farms further from the city, we will be able to continue to farm our land. Increase our assessments only if we sell the land for another use. This policy will also benefit the people of the city. They will be able to obtain fresh vegetables and dairy products at lower prices since transportation costs will be lower. But act now before it is too late.

Student Handout 13

"THE BUSINESS OWNERS COALITION FOR A BETTER AMERICA" TESTIMONY

As the honorable members of this committee well know, businesses are leaving this state for greener pastures. Not only are labor costs higher than in many other parts of the country, but the property tax is cutting deeply into our revenues. We have to pay most of our other taxes only if we make a profit. But a property tax stands out in stark contrast. It is a fixed cost that we pay whether we make a profit or not.

We know there is no need to remind you that business provides the jobs that are the lifeblood of the economy of this state. We are not asking for a total exemption from property tax, although such exemptions are given in some other states. We want only to be treated fairly.

Eliminate the tax on our inventories, machinery, office equipment, and other business property. This tax discriminates against businesses with large inventories and large amounts of equipment. Remember that it is the capital investments of business that provide jobs. This is truly an unreasonable tax. When the economy goes into a recession and sales drop off, our inventories build up and our property tax is increased automatically. At a time when we have the least ability to pay taxes, our taxes are the highest!

Finally, put a limit on changes in our assessments. We have to be able to make future investment decisions. An increase in property taxes may be the difference between profit and loss. Stabilize our property assessment for a period of time such as ten years. All the people of the state will benefit from this policy through higher employment for labor and lower prices for finished products.

Student Handout 14

"HOMEOWNERS IMPROVEMENT ASSOCIATION" TESTIMONY

A recent survey showed that less than one-fourth of the American people could afford the American dream of a new home. Even current homeowners are having trouble hanging onto this dream. Every year property taxes rise higher and higher. The homeowner needs tax relief now.

Homeownership is good for America. Homeowners maintain their property better than absentee landowners. This improves the entire community.

How can you help homeowners obtain tax relief and still provide revenue for essential city services? The answer is to tax the big money boys. Tax the absentee landlords, and tax the corporate owners of large office buildings and industrial plants. You could do this by assessing property at different percentages of true market value. First, determine market value. Tax single-family homes at 20 percent of market value. Tax apartment buildings and commercial property at 30 percent of market value. Tax industrial property at 40 percent of market value. Then levy the same tax rate on all three types of property. Of course, the owners of commercial and industrial property would pay a proportionately larger tax bill since their assessments would be a higher percentage of market value. This will put the tax burden where it belongs and reward the homeowners who do so much for their communities.

Student Handout 15

"SENIOR CITIZENS ACTION PROGRAM" TESTIMONY

Many senior citizens in this country live on incomes which are below the official poverty line. Some surveys indicate that 50 percent of America's senior citizens live in poverty. Many senior members of our community are homeowners while others rent. In both cases they are hit hard by property taxes. During their working years many retired people bought homes. Their home is their fondest possession. Although the mortgage is paid, they cannot afford the property taxes. Property taxes rise while the retired worker's income stays the same.

We propose property tax relief for senior citizens in the form of a circuit-breaker. A circuit-breaker breaks the circuit of higher taxes if property taxes are overwhelming a senior citizen.

This law would help only those senior citizens who are poor. They would receive a rebate of a portion of their income tax if their property taxes exceeded 3 percent of their income. For example, take the following situation:

Income	$6,000
Total property tax due	600
Property tax liability ($6,000 × 0.03)	180
Rebate due	420

This homeowner would have to pay $180 in property tax. This tax bill of $600 would be paid, but the state would rebate $420. That sum would either be deducted from any state income tax liability or, if the rebate was more than the income tax owed, a check would be sent to the senior citizen.

Elderly tenants would allocate 25 percent of their rent as a property tax. After all, a landlord passes on property taxes in the rent charged. The renter's rebate would be calculated as follows:

Rent = $150 per month × 12 months in the year
= $1,800
Property tax share: $1,800 × 0.25 = $450
Income: $5,000
Property tax liability: $5,000 = 0.03 = $150
Tax rebate: $300

It is time our society began to honor and respect its senior citizens. This circuit-breaker program would provide relief for those citizens who need it. Certainly, we can help see that our senior citizens have an adequate standard of living during retirement.

Student Handout 16

"CITIZENS FOR EQUAL EDUCATIONAL OPPORTUNITY" TESTIMONY

We feel the children of this state have the right to a quality education. However, many children are deprived of a quality education because of where they happen to live. The property tax is the most important revenue source for the public schools. And the amount of money that can be raised depends on the value of the property in the school district. We will illustrate the effect of this by showing you two school districts that actually exist in our state.

	District A	**District B**
Value of property	$200,000,000	$100,000,000
Number of pupils	2,000	4,000
Wealth per pupil	$100,000	$25,000
Tax rate per $100	$2.00	$2.00
Tax revenue per pupil	$100,000 × .02 = $2,000	$25,000 × .02 = $500

Now, the honorable members of this committee can see that both districts are making equal efforts to provide a good education. Both impose a tax of $2 per $100 of assessed valuation. But District A can spend four times as much money on its students. Is that fair? Is it wise?

Many years ago most people lived out their days and were buried not far from where they were born. In those days good schools brought benefits to the local community and local taxes paid for them.

Today many Americans are on the move. The rewards of a good educational program and the penalties of a poor one are visited on communities other than those where the education took place. We cannot afford to have children losing out on a good education because they live in the wrong place.

We urge you to finance all schools on a statewide basis. Abolish the local property tax and impose a statewide property tax or an income tax. Then provide equal funding for all schools. Provide every child of this state with equal educational opportunity.

Student Handout 17

INSTRUCTIONS FOR THE FINANCE COMMITTEE OF THE STATE HOUSE OF REPRESENTATIVES

You are members of the Finance Committee of the State House of Representatives. It is your job to write tax bills. After you write a bill, it will go to the entire House. If the entire House passes it, it will go to the State Senate. If the State Senate also passes the bill, it will go to the Governor, who must sign it for it to become law.

The members of the State Legislature rely on your expertise on tax matters. Any bill you recommend has a good chance of passing. Your responsibilities are great.

Recently, there has been a public outcry against the property tax. Homeowners, businesses, senior citizens, city officials, farmers, and educators are all attacking the property tax. Unfortunately for you, they are attacking it for different reasons. You are holding public hearings on property tax reform. You need these people's votes to be re-elected. Many of their reforms require tax relief. That will cost local governments money. If the state government is expected to make up the difference, the state may have a revenue problem. Of course, the local governments must accept the state's decisions by law.

Complicating your problem is the fact that many of the tax reform advocates demand high-quality public services. They would be shocked if you suggested a reduction in police protection, fire protection, education, garbage collection, library services, street maintenance, or recreational facilities.

Many of these proposed reforms would reduce property tax revenue. How would you replace these revenues? Be sure to consider this problem in your deliberations.

You knew you had to make tough decisions when you ran for public office. After hearing the testimony, the committee must write a tax reform proposal. Be sure to question all witnesses thoroughly. Find out what they really want. Then put your heads together to write a property tax reform bill. Be prepared to justify your bill to the voters.

Instructional Activity 8

A TALE OF TWO TAXPAYERS

Recommended Use: This developmental activity involves calculating the taxes for a person with an income substantially above the U.S. median income and for a person with an income below the U.S. median. It is recommended that the students calculate the taxes themselves unless a majority in a class are poor in arithmetic.

Time Required: At least one 45-minute period.

Materials Required: Student Handout 18. Teachers may wish to modify this problem sheet to reflect their actual state and local taxes. For example, the problem sheet assumes a flat-rate state income tax and a sales tax on food. Your state may not have these taxes.

Rationale: The purpose of this exercise is to personalize the tax equity issue. By actually calculating the total tax liability of taxpayers in two different income brackets, students should be able to comprehend the total impact of the myriad of taxes on spendable income. In addition, the exercise emphasizes the bases of taxation and the integrated approach to taxation used in the United States.

Concepts: Tax equity, integrated approach to taxation, bases of taxation.

Instructional Objectives: After reading Handout 18, "A Tale of Two Taxpayers," students should be able to:

1. Calculate the taxes for a high-income and for a low-income person (high-ability students only);
2. Classify by base the taxes each person paid;
3. Compare and contrast the equity of state and local taxes with federal taxes;
4. State in their own words their perception of "fair" taxation;
5. Compare and contrast the economic advantages of a tax with its political advantages.

Teaching Strategy	Pupil Activity
1. Distribute Handout 18. Either have the students calculate the taxes for Terry Young and Harold Washington or have them read the taxes that have already been calculated. One way to help them to understand these taxes is to place questions such as the ones used in this exercise on the chalkboard. The rest of this activity consists of the questions and possible answers.	Higher-ability classes calculate taxes. Students also could work in small groups and answer questions on the board.
2. Ask:	
a. Which of these taxes use consumption as a base; which use wealth as a base; which use income as a base?	Students should have no problem with this question if they have completed Instructional Activity 1.

b. Which of these taxes are progressive; which proportional; which regressive?	The federal personal income tax is progressive; the state income tax is proportional; most other taxes are regressive.
c. Do you think the taxes on cigarettes and alcohol are fair?	Students may disagree. Some may argue that the tax can be avoided if a person does not drink or smoke. It should be noted that these taxes are highly regressive.
d. Why did we calculate a $525 property tax on Terry Young even though he rented and paid no property tax?	We presumed that the property tax is shifted to the renter. It is more certain that taxes on cigarettes, alcohol, and gasoline are shifted to the buyers; the businesses pay the tax to the government, but the consumer pays back these taxes to the businesses as part of the retail price.
e. How does the tax liability of the low-income taxpayer, Terry Young, compare to that of the high-income taxpayer, Harold Washington? In other words, what percentage of their incomes is paid out for taxes?	In this example, Terry Young's tax liability and Harold Washington's tax liability are approximately the same: Young, 30.4 percent; Washington, 31.2 percent.
f. Are these two examples representative of the U.S. tax system? What changes might make these tax liabilities different?	The value of deductions taken on the federal income tax is a big factor in total tax liability. If either taxpayer had more deductions, his tax liability would be reduced. The richer taxpayer probably would have the better chance of using more deductions. Most state income taxes are progressive, and some state sales taxes exempt food. Both factors would reduce the poorer taxpayer's liability compared to the richer taxpayer's. The taxes on alcohol, cigarettes, and gasoline could be avoided by lower consumption of these products.
g. How does the equity of the state and local tax system compare to that of the federal tax system?	The federal tax system is progressive while the state and local tax systems are probably regressive.
h. Do you think that both taxpayers are taxed fairly?	This is a wide-open question. A few students may think that Harold Washington is getting a raw deal because he pays more dollars in taxes. Some may think the tax burdens are fair because the two taxpayers pay approximately the same rate. Others may say that compared to his income, Terry Young sacrifices more. Thirty percent of $8,000 means sacrificing necessities while 30 percent of $25,000 means sacrificing luxuries. This *equal sacrifice theory* is the rationale for progressive taxation or ability-to-pay taxation.
i. Many of the consumer taxes are regressive. Why do we have them?	These hidden taxes are politically acceptable.
j. How would you change the mix of these taxes to make the total tax system fairer?	Students could divide into small groups to come up with a plan.
k. Assume you are a state legislator and have to obtain more revenue to finance state services. What taxes would you increase? Why?	Answers will vary, but increasing hidden consumer taxes might be tempting.

Student Handout 18

A TALE OF TWO TAXPAYERS

We're going to look at the taxes paid by two families on their 1975 incomes.

Taxpayer One is Harold Washington. He lived with his wife and two children in a $40,000 house. Their annual income was $25,000 and he spent $15,000 on products that were subject to a 4 percent state sales tax. In order to entertain friends, Harold bought about five gallons of liquor a year. Harold and his wife each smoked about a pack of cigarettes a day. They owned two cars consuming about 2,000 gallons of gas a year. But gasoline was not the only energy source the Washingtons used, for their utility bills totaled $600 a year. How much total tax did Harold pay?

Harold Washington's taxes. (State and local taxes are illustrative estimates. Actual taxes vary from place to place.)

1. Federal income tax

Adjusted gross income	$25,000
Itemized deductions	−3,000
Personal exemptions, 4 at $750 each	−3,000
Taxable income	19,000
Tax (per Schedule Y—"Married Taxpayers . . ."—for 1975)	4,100

NOTE: Mr. Washington may have been able to obtain more deductions than $3,000 worth. His mortgage and property taxes alone probably totaled more than $2,000. So the federal income tax given is approximate. (Possible 1975 tax credits are not calculated.)

Also note that Mr. Washington's adjusted gross income is the same as his annual salary; for other taxpayers, there may be a difference.

2. Social security tax (5.85% of first $14,100 of earnings):[1]
   $14,100 × .0585 = $824.85

3. State sales tax 4%: $15,000 × .04 = $600

4. State income tax

Adjusted gross income	$25,000
4 exemptions at $750 each	−3,000
Taxable income	22,000
Tax rate 3%	660

5. Cigarette tax
   State: 12 cents a pack
   Federal: 8 cents a pack
   730 packs × $.20 = $146

6. Alcohol tax
   State: $2.50 a gallon
   Federal: $10.50 a gallon
   5 gallons × $13.00 = $65.00

7. Property tax: Assessed at 50% of market value
   Tax rate: $5 per $100 of assessed valuation
   $40,000 × .5 × .05 (rate) =$1,000

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[1] This was the social security tax prevailing in 1975.

Student Handout 18 (continued)

8. State utility tax: 5% of bill
   $600 × .05 =$30
9. Gasoline tax
   State: 8 cents a gallon
   Federal: 4 cents a gallon
   2,000 gallons × $.12 = $240
10. Car licenses: $30 each = $60
11. Car city stickers: $10 each = $20

HOW MUCH TOTAL TAX DOES HAROLD WASHINGTON PAY?

ANS: $7,745.85

WHAT PERCENTAGE OF MR. WASHINGTON'S INCOME GOES FOR TAXES?[2]

ANS: $\frac{\$\ 7{,}745.85}{\$25{,}000} = 30.98\%$

Taxpayer Two is Terry Young. He lived with his wife and two children in an apartment they rented for $175 a month. They were barely getting by on his $8,000 a year income in 1975. After paying more than $1,000 in federal and state income taxes and the social security tax, the family had less than $6,000 to spend. They nevertheless were able to *purchase* $7,000 worth of products because they bought a car on credit. Among the other things Mr. Young bought were five gallons of spirits such as whiskey and vodka. His income was really drained by his smoking habit. He and wife have tried to stop smoking but have always failed. Together—like the Washingtons—the Youngs smoked two packs a day. Mr. Young's car consumed 1,250 gallons of gas in 1975. The Youngs' utility bills added up to $400 a year. How much tax did Mr. Young pay?
Terry Young's taxes.

1. Federal income tax

Adjusted gross income (AGI)	$8,000
Standard deduction	−1,200
4 exemptions at $750 each	−3,000
Taxable income	3,800
Tax	586

NOTE: Mr. Young probably would not be able to save taxes by itemizing his deductions. For example, he does not own a home. His rent covers his landlord's mortgage interest and property taxes, but his landlord is the one who pays them directly and deducts them on his income tax.

2. Social security tax (5.85% of first $14,100 of earnings)
   $8,000 × .0585 = $468
3. State sales tax 4%: $7,000 × .04 =$280
4. State income tax

Adjusted gross income	$8,000
4 exemptions at $750 each	−3,000

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[2] The calculated percentage does not include the hidden taxes included in the price of things Mr. Washington bought. The same applies to the computation for Mr. Young's tax rate, which follows.

Student Handout 18 (concluded)

Taxable income	5,000
Tax rate 3%	150

5. Cigarette tax
State: 12 cents a pack
Federal: 8 cents a pack
730 packs × $.20 = $146

6. Alcohol tax
State: $2.50 a gallon
Federal: $10.50 a gallon
5 gallons × $13.00 = $65.00

7. Property tax (assumed to be 25% of rent)
($2,100) (rent) × .25 = $525

8. State utility tax: 5% of bill
$400 × .05 = $20

9. Gasoline tax
State: 8 cents a gallon
Federal: 4 cents a gallon
1,250 gallons × $.12 = $150

10. Car license: $30

11. Car city sticker: $10

HOW MUCH TAX DOES TERRY YOUNG PAY?

ANS: $2,430

WHAT PERCENTAGE OF MR. YOUNG'S INCOME GOES FOR TAXES?

ANS: $\frac{\$2,430}{\$8,000} = 30.38\%$

Instructional Activity 9

COMPUTING AND UNDERSTANDING YOUR INCOME TAXES

Recommended Use: This developmental lesson can be used in consumer education, business, or economics classes. It uses the students' interest in learning how to compute taxes to introduce them to federal income tax policy.

Time Required: To fill out forms 1040a and 1040 properly, most classes will require about eight days. Two additional 45-minute periods will be necessary to study tax policy considerations.

Materials Required: Student Handout 19; a classroom set of income tax forms. *Understanding Taxes,** a booklet available from the Internal Revenue Service, is helpful. Two useful books for teacher background on the tax equity issues are Freeman (1973), which defends "tax loopholes," and Stern (1973), which criticizes them.

Rationale: Computing income taxes is an annual rite for Americans. Unfortunately, many cannot complete this task alone. They therefore turn to tax preparation services, some of which may be inept. This lesson will help students to compute federal income taxes accurately. More important, it will help them to evaluate the basic premises of the income tax laws. An understanding of our tax laws is essential in order for citizens to influence Congress and the President to make our income tax laws conform to the criteria of a good tax.

Concepts: Federal income tax laws, tax preparation, adjusted gross income, tax deductions, tax exemptions, tax equity, taxable income.

Instructional Objectives: After reading *Understanding Taxes* and completing numerous tax returns, students should be able to:

1. Interpret the W-2 form;
2. Prepare the 1040a form properly;
3. Determine whether filing separate returns or a joint return saves money for a married couple;
4. Determine how to report dividend and interest income;
5. Determine whether using a standard deduction or itemizing deductions saves money;
6. Prepare the 1040 form properly;
7. Distinguish between the total tax paid and the balance due or refund;
8. Describe the political implications of the withholding system;
9. Evaluate various provisions of the federal income tax including exemptions, deductions for medical expenses, state and local taxes, interest expenses,

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*Understanding Taxes is published annually. Copies may be obtained by writing to IRS Data Center/Project TKIT/Attn: *Understanding Taxes* Coordinator/address of district IRS office.

charitable contributions, casualty and theft losses, children and dependents, and the exclusion of capital gains and interest on state and municipal bonds.

Teaching Strategy	Pupil Activity
1. Give a lecture on the federal income tax. Show students the general layout of the federal tax forms. To compute one's income tax these steps must be taken: **Step 1:** Compute adjusted gross income. **Step 2:** Reduce adjusted gross income to taxable income by subtracting deductions and exemptions. **Step 3:** Compute taxes. Point out that the tax is progressive, ranging from 14% to 70% on taxable income. Also point out that these rates are the nominal rates and that few taxpayers pay an effective rate even close to 70%. Even the nominal rate for a millionaire is not 70% since everyone pays 14% on the first $500 of taxable income. You might make a transparency of the X, Y, Z tax schedules.[1] Show students that the progressive tax rates are on marginal or extra income. Everyone, regardless of how much money earned, pays 14% on the first $500 ($1,000 joint) of taxable income; 15% on the next $500 ($1,000 joint), etc. The highest rate (70%) is levied only on certain types of income in excess of $100,000 ($200,000 joint). For these reasons no one can pay an effective rate of 70%. Many people have the mistaken idea that increased gross income can result in reduced net income because of higher tax rates. Schedules X, Y, Z show that is impossible. **Step 4:** Compare the tax owed with the tax already paid through withholding. In order to avoid confusion, point out that the tax tables combine Steps 2 and 3.	
2. Have students read Chapters 2 and 3 of *Understanding Taxes.*[2] Distribute Handout 19. Have students read tax problem concerning taxpayer named "Oh Wow Man." No tax is owed in this problem. When students have finished preparing returns, put correct return on transparency or board and go over it. Ask questions such as the following:	Students read and then work on tax return.
a. Did Oh Wow Man pay any federal income tax?	No.
b. Did the federal government pay Oh Wow Man?	Many students will say yes. They will not understand that Oh Wow Man is receiving his own money back.

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[1] Note: These schedules may bear a different designation in the latest federal tax instructions and the rates may differ.

[2] In the 1979 edition of *Understanding Taxes,* Chapter 2 was called "Tax Information for Your First Job"; Chapter 3, "Information on Form 1040A"; Chapter 4, "Form 1040 and Schedule A."

c. What is the purpose of withholding?	To make paying taxes less painful and therefore more politically acceptable. Withholding also makes the tax easier to collect and administer since employers send the withheld taxes of all their employees to the government in one batch.
3. Have students prepare "I Am Cool." Then go over return. Students must calculate tax using the tax table included in the Form 1040a booklet. They also learn how to compute interest income, dividend income, and campaign contributions. Go over return on transparency. Ask questions such as these:	Students prepare return.
a. How much tax did I Am Cool pay?	Some students may still say he owed nothing since he got a refund, but I Am Cool paid tax.
b. Why is there a $100 exclusion on dividend income?	Congress felt it would help avoid double taxation since corporate profits (the source of the dividends) are taxed. The $100 figure, like much tax legislation, was a compromise.
c. Why is I Am Cool allowed to have a tax credit for his contribution to Senator Smith?	Congress wanted to encourage small contributions to campaigns to reduce the influence of big money on elections. The largest tax credit possible is $25.
d. Do you approve of this law?	Answers will vary.
4. Have students read Chapter 3 of *Understanding Taxes.* Hand out "Ima and Youra Dope." This introduces students to a joint return. Go over return after students finish. Ask questions such as the following:	Students read and prepare returns.
a. When students have just about finished computing adjusted gross income, point out that the municipal bond interest is not included in adjusted gross income. Then ask if this is fair.	The original exemption may have developed because of constitutional questions. In *McCulloch* v. *Maryland* Chief Justice John Marshall said, "The power to tax involves the power to destroy." Therefore, one government cannot tax another. By this reasoning, the federal government may not tax the interest on state or local bonds. However, subsequent decisions have allowed the federal government to tax the salaries of state employees, and most constitutional experts believe taxing interest from municipal bonds would be constitutional. In addition to the constitutional question, there are economic considerations. The rationale is that the practice allows state and local governments to finance activities at lower interest rates. Of course, it is a giant tax break for some of the rich. Some economists say that direct subsidies to the local governments would be cheaper.
b. At this time do you see some other purposes of the federal income tax besides raising revenue?	The federal income tax is used to promote the kinds of goals that Congress feels are desirable
5. Have students read Chapter 4 of *Understanding Taxes.* Have them complete the tax return for the Storys. This form requires itemized deductions. It also requires students to interpret a W-2 form. Go over return on transparency. Now it is time really to question the income tax laws. Examine the purpose behind all the deductions and exemptions. If there is not enough diversity	Students read and prepare returns.

of opinion in the class, play the devil's advocate. Here are some possible questions:

a. What is the purpose of exemptions? Who gains by exemptions?	Personal exemptions are given because low-income people have no taxpaying capacity. Taxation below minimum subsistence levels reduces health and efficiency, lowers worker productivity, and probably raises public outlays for social welfare. Exemptions enhance tax progressivity and remove from the tax rolls people with very low income, thus lowering administrative costs. At higher incomes, personal exemptions moderate tax burdens as the number of dependents increases. Exemptions for those over 65 and the blind are based on similar reasons.
b. Is the extra exemption for blind people fair?	If students say yes, ask why there are no exemptions for other physical disabilities. The answer is that the blind have more political influence. Also, how fair is an extra exemption for a blind millionaire?
c. What is the purpose of the deduction for medical expenses? Is it fair?	It puts the tax more in line with ability to pay because it lowers taxes for people with large unavoidable medical bills. But since only one-half of insurance premiums are directly deductible, it may discriminate against people with medical insurance.
d. Why are state and local taxes deductible?	Because otherwise in theory, one could pay taxes amounting to more than one's income. But this has never happened.
e. What is the purpose of the charitable contributions deduction? Do you approve of this deduction?	Its purpose is to encourage charitable contributions. But in the case of contributions to religious organizations, is it a violation of the separation of church and state?
f. Why are interest expenses deductible?	Congress wanted principally to encourage homeownership. Does this discriminate against renters? Note that other interest—in this case, that paid on installment purchases—is also deductible.

NOTE: Other deductions can be examined using the same questioning strategy. Be sure to explore the pros and cons of each deduction. Don't forget capital gains.

6. Now discuss tax rates:

a. How much is the nominal tax rate for income over $100,000?	70 percent.
b. What is the effective tax rate for different incomes?	Students can only guess, but here are the average effective tax rates for selected income brackets in 1972 as given in a Brookings Institution study by Joseph Pechman and Benjamin Okner:

Family Income	*Effective Tax Rate*
$ 2,000–$ 3,000	0.5%
5,000– 6,000	2.8
10,000– 11,000	7.6
20,000– 25,000	12.1
75,000– 100,000	26.8
200,000– 500,000	29.6
500,000– 1,000,000	30.4
Over $1,000,000	32.1

Of course, some people pay more, and some pay less than the average.

c. Is the federal income tax a progressive tax?	Yes, but not as progressive as the nominal rates would make it appear.
7. Divide students into small groups and have them write and justify a tax reform proposal. They must write three different proposals that would improve the federal income tax. Be sure to tell them to justify each proposal against the criteria of a good tax. For example, if they feel municipal bond interest should be taxed, they must explain why.	Students meet and then report on their proposals. Challenge their proposals and make students evaluate them against the criteria of a good tax.
8. Ask students if eliminating all deductions (or "tax subsidies," as experts term them) is a good idea.	This would make the income tax conform more to the criterion of neutrality. It would also make the tax forms simpler. According to Phillip Stern, if all tax deductions were eliminated, the federal government could collect $77 billion in additional revenue (as of 1972). This money could be used to subsidize worthy activities rather than for tax subsidies. If, instead of obtaining more tax revenues, the government only wanted to collect as much revenue as it actually did in 1972, it could have cut the then existing tax rates by 40 percent.

Evaluation: Students should correctly prepare 1040a and 1040 tax returns. The tax reform proposals of each group can be used to evaluate the tax policy objectives.

Student Handout 19

INCOME TAX PROBLEMS

Income Tax Problem 1040a

The following situation is for a typical high school student who tries to fill out his federal income tax.

Name: Oh Wow Man
Address: 111 Fruitcake Blvd., Los Angeles, California
Social security no.: 123-45-6789
Situation: Oh is single with no physical handicaps. He has only one source of income, the $2,000 he earned working last summer as a model for a mannequin maker. His employer took care of his withholding for income tax purposes, and Oh got his W-2 form in the mail and discovered that a total of $318.75 had been withheld.

Income Tax Problem 1040a

The following situation is for a typical high school student who tries to fill out his federal income tax.

Name: I Am Cool
Address: 333 Warm Street, Santa Claus, Indiana
Social security no.: 987-65-4321
Situation: I is single with no physical handicaps. He received $4,000 from his part-time job washing windows in a Butler Building. I also has a savings account on which he earned $196.50 interest and has stock which paid him $187 in dividends. In all his generosity I gave $10 to the campaign fund of Senator Smith.
Tax withheld: $539.25

Income Tax Problem 1040

Ima and Youra Dope
000 IQ Lane, Nowhere, Texas

Ima's income is as follows:
$9,750 as manager of a store
$300 interest on savings account
$750 General Motors stock dividend
Social security no.: 341-56-8675

Youra's income is as follows:
$8,700 as a nurse
$400 interest from a high school district bond
Social security no.: 827-87-3701

Withholding:
Ima: $1,700
Youra: $1,300

Student Handout 19 (concluded)

Income Tax Problem 1040

1 Control number	222	2 Employer's State number 98-7654321	For Official Use Only	
3 Employer's name, address, and ZIP code TOWN INDUSTRIES CO. 14 NORTH HIGHWAY HOMETOWN, IL 10002		4 Sub-total ☐ Correction ☐ Void ☐ 7 Employer's identification number 98-7654321	Make No Entry Here	
10 Employee's social security number 000-00-0000	11 Federal income tax withheld $1,098.00	12 Wages, tips, other compensation $13,000.00	13 FICA tax withheld $786.50	14 Total FICA wages $13,000.00
15 Employee's name (first, middle, last) Sally S. Story		16 Pension plan coverage? Yes/No No	17*	18 FICA tips XX
111 N. Kedzie St. Hometown, IL 10001 19 Employee's address and ZIP code		20 State income tax withheld $325.00	21 State wages, tips, etc. $13,000.00	22 Name of State IL
		23 Local income tax withheld XX	24 Local wages, tips, etc. XX	25 Name of locality XX
Wage and Tax Statement		1978	Copy C For employee's records	

Form W–2

Department of the Treasury—Internal Revenue Service

Sam S. and Sally S. Story
They have two children: Short, 5; Sad, 7
Mr. Story is a househusband

Union dues		$ 150
Dividends		
Arvin (H)	$ 300	
IBM (H&W)	400	
AT&T (W)	700	
Moving expense		500
Total interest on all installment purchases		335.97
Medicine and drugs		495
Total medical and dental expenses		225
Life insurance premiums		120
Health insurance premiums		180

Interest		
U.S. savings bond	$ 45	
Bank of America	28	
Credit union	13	
Municipal bond	75	
Real estate taxes		$1,000
Interest on home mortgage		2,000
Contributions		
Library fund	500	
Church	100	
Cancer fund	75	
State income tax	400	
Gasoline use: 30,000 miles driven		

Mrs. Story has decided again this year to itemize her deductions.

Instructional Activity 10

THE POLITICS OF TAXATION: PORTRAITS OF TWO TAX LAWS

Recommended Use:	This developmental activity can be used in an economics unit on economic stability or in a political science unit on lawmaking. In either case, the lesson shows the interaction of economics and politics in writing and passing tax legislation. Some knowledge of the concept of economic stability and of the legislative process would be helpful to students before they begin this lesson.
Time Required:	One 45-minute period.
Materials Required:	Student Handouts 20 and 21.
Rationale:	If citizens are to influence tax legislation, they must understand the legislative process.
Concepts:	Stabilization role of taxes, steps in legislative process, interaction of politics and economics in tax legislation, power, authority, participation.
Instructional Objectives:	After reading Handouts 20 and 21, "The 1975 Federal Income Tax Cut" and "The Tax Increase of 1968," students should be able to: 1. Describe the steps through which tax legislation must pass to become law; 2. Identify the individuals, committees, and groups influential in writing and passing tax legislation; 3. Evaluate tax change (increases and decreases) as a tool for economic stability; 4. List methods citizens can use to influence tax legislation.

Teaching Strategy	**Pupil Activity**
1. Distribute and have students read Handout 20. To guide their reading, write some of the questions used in this activity on the chalkboard.	Students read the handout.
2. Ask questions such as these:	
a. Why did President Ford request a tax decrease? What role of taxation was represented by this request?	He thought a tax decrease would stimulate the economy by increasing consumer demand. This represents the stabilization role of taxes.
b. What steps did the tax legislation go through before becoming law? Write the steps on the board as students describe them.	(1) President requests legislation. The President often initiates legislation although the bill must be introduced in the Congress by a member. (Any person or group can request that bills be introduced.) (2) House consideration. (a) Ways and Means Committee. (b) Rules Committee. (c) Floor debate and vote.

	(3) Senate consideration. (a) Finance Committee. (b) Floor debate and vote. (4) Conference Committee. (5) Presidential signature.
c. In what ways was the final tax legislation different from the bill proposed by the President? What accounted for the difference?	The differences are described in the reading. In Congress many members and lobbyists have special interests that they think are important to the nation's welfare. Trade-offs are made. Some observers believe that tax bills become "Christmas tree bills" with a little gift for everyone. This political process is largely responsible for the great variety of taxes that Americans pay.
d. Which of the three roles of taxation was President Ford most concerned with? What additional roles was the Democratic congressional leadership concerned with?	Ford was mainly concerned with the stabilization role. Congress was equally concerned with equity. The final version gave larger tax breaks to low-income families than the President wanted. It also eliminated the oil depletion allowance.
e. Why did liberal Democrats couple the elimination of the oil depletion allowance with the tax cut bill? Do you think this was a good strategy?	The strategy worked. Special interests, like the oil industry, often prevail when there is little public interest in a bill. There was considerable public interest in the tax bill.
f. If you wanted to influence tax legislation, how would you do it?	The congressional committees are very important. Therefore, one should influence committee consideration and not wait until the bill reaches the floor.
3. Distribute and have students read Handout 21.	Students read the handout.
4. Ask questions such as the following:	
a. Why did President Johnson delay requesting a tax increase for nineteen months?	Tax increases are unpopular, especially to finance unpopular wars.
b. Why did President Johnson request a tax increase?	He felt it would reduce consumer demand by leaving them with less after-tax income and thus lessen inflationary pressures.
c. Why did Congress take ten months to pass the 1968 tax increase and only three months to pass the 1975 tax decrease? What implications does this have for using taxes as a tool of economic stability?	Tax increases are unpopular politically while tax decreases are popular. When the needs of economic stabilization correspond to the political popularity of a tax decrease, taxes may work quickly—and therefore well—as a tool of economic stability. When taxes should be increased for stabilization purposes, it is hard to pass higher taxes in time.

Student Handout 20

THE 1975 FEDERAL INCOME TAX CUT

In late 1974 the U.S. economy was in deep trouble. Consumer prices were rising at an annual rate of over 11 percent. In the fall of that year, President Gerald Ford, a Republican, proposed a tax increase to "whip inflation now." He asserted that this tax increase would lower consumer spendable income and consequently would lower consumer demand and slow inflation. The Democratic-controlled Congress scorned the program. No action was taken on it.

By 1975 the nation's economic woes had increased. Inflation was continuing and unemployment was climbing toward 10 percent of the labor force. In his annual State of the Union message, the President told Congress that curbing unemployment was now his highest priority. "The emphasis on our economic efforts must now shift from inflation to jobs." He thereupon proposed a $16 billion cut in the taxes to be paid in 1975 on 1974 income. This one-shot tax reduction was designed to stimulate consumer spending. Twelve percent of the taxes due on the 1974 income of individuals would be rebated. Here are some examples of the rebates due to a family of four under the proposal:

Adjusted Gross Income	Proposed Rebate
$ 5,000	$ 12
10,000	104
15,000	204
20,000	319
40,000	955
50,000 and over	1,000

President Ford wanted the larger rebates to go to middle- and upper-income families since they would be more likely to use the rebates to buy cars and appliances than would low-income families. Buying of such goods would do the most to stimulate the economy and increase employment.

Leaders of the Democratic-controlled Congress attacked the President's tax cut as too little too late. Moreover, declared House Speaker Carl Albert, "President Ford's proposal for a rebate of 1974 taxes puts 43 percent of the refund into the richest 17 percent of the population." Other Democrats joined in charging that the program favored the rich over the poor.

Congressman Al Ullman, chairman of the House Ways and Means Committee, introduced his own tax plan. The Ways and Means Committee writes or considers all tax legislation before it goes to the House floor for debate. Ullman's proposal provided more relief for lower-income families than Ford's. Ullman advocated a 10 percent rebate on 1974 taxes. In addition, his plan provided a tax cut on 1975 income to be made through certain tax credits and larger standard deductions. The Ways and Means Committee

Student Handout 20 (continued)

quickly passed Ullman's proposal with minor modifications. Rebates on 1974 taxes for a family of four under the Ways and Means plan were as follows:

Adjusted Gross Income	Proposed Rebate
$ 5,000	$ 98
10,000	100
15,000	170
20,000	200
30,000 and over	100

Before the bill could go to the entire House, the House Rules Committee had to approve it. This committee determines what bills go to the House floor. The Rules Committee added a provision to the Ways and Means bill. It proposed the elimination of the oil depletion allowance, a loophole that benefited oil companies. What started out as tax reduction in part became a tax increase for oil companies. The Rules Committee had added tax reform to tax reduction. It did so because the House Democratic Caucus wanted the Rules Committee to get rid of the oil depletion allowance. (The Caucus consists of all Democrats in the House of Representatives. It helps to determine Democratic policy decisions.) The Rules Committee did not have to follow the Caucus's mandate, but it did. Chairman Ullman of Ways and Means felt that adding tax reform would slow passage of the tax reduction bill, but liberal Democrats felt they had trapped oil company lobbyists who could not hope to defeat a bill also containing a general tax cut in order to preserve the oil depletion allowance.

The tax cut bill was approved by the full House by 317-97. The bill was essentially the Ways and Means bill with the amendment eliminating the oil depletion allowance. The total revenue loss involved was $20 billion.

The bill then moved to the Senate, where it was first considered by the Senate Finance Committee chaired by Democrat Russell B. Long. Long, an influential oil industry supporter, was expected to strike out the removal of the oil depletion allowance. The Finance Committee as a whole, however, recommended ending the allowance only for the large oil companies. Companies producing less than 2,000 barrels of oil a day would still qualify for the depletion allowance.

The Senate Finance Committee also added numerous other provisions. People buying a new or used home could receive an income tax credit of up to $2,000. Social security recipients were granted a $100 tax bonus. Although the committee retained the House-passed rebate formula on 1974 income taxes, it substantially increased the 1975 tax cuts by increasing standard deductions, low-income allowances, and tax credits for dependents.

When the bill went to the full Senate, oil industry supporters threatened to filibuster the bill, that is, talk it to death. But the Senate could limit debate by invoking cloture (legislatures in the United States traditionally use this word instead of closure). To obtain cloture requires 60 votes. The Senators, of course, did not want to vote against so popular a measure as a tax cut bill. So they invoked cloture and then on March 21, 1975, passed the bill on a 60-29 roll call vote. The Senate version of the bill would have cost $30 billion.

The Senate and House bills differed significantly. The Senate bill's price tag was $10 billion more than the House bill's and President Ford threatened to veto the Senate version because it was too expensive. The differences had to be resolved in a conference committee, where members of both the House and Senate hammered out a compromise bill. The House conferees managed

Student Handout 20 (concluded)

to reduce or eliminate many provisions added by the Senate. The conference committee version emerged with the following provisions:

- A 10 percent rebate on 1974 taxes up to a maximum of $200, which was the House formula.
- Increased standard deductions and tax credits on 1975 taxes, but not as great as in the Senate bill.
- An increased deduction for families needing child care because both parents work.
- A tax credit of up to $2,000 for people buying a new home finished or under construction by March 26, 1975. This reduced the total revenue loss involved in the Senate-passed home credit considerably.
- A $50 "bonus" for social security recipients.
- Elimination of the oil depletion allowance for large oil companies.

The new bill cost $23 billion in tax revenues. The conference proposal was presented to the House and Senate on March 26, 1975. It passed the House by a 287-125 vote and the Senate by a 45-16 vote.

It was now up to President Ford. He felt the bill was too costly. If the tax cut bill became law, the government would spend $60 billion more than it would collect in taxes. The President felt that so large a budget deficit could be inflationary. Nevertheless, on March 29 the President signed the bill. He declared the $23 billion tax cut was "within reason." But he expected Congress to hold the line on increased government spending so as to minimize the deficit.

In its final form the tax cut law was considerably different from the one proposed by President Ford just three months earlier.

Student Handout 21

THE TAX INCREASE OF 1968

In 1966 the United States was at the peak of prosperity and the unemployment rate stood at 3.8 percent.

Nevertheless, President Lyndon Johnson, a Democrat, knew the country was in trouble. He had increased American involvement in the Vietnam War greatly. To fight the war, President Johnson and Congress added billions to federal expenditures. If taxes were not increased also, there would be a large deficit in the federal budget. Although a deficit might be a good thing during a period of unemployment, this was not such a time. Factories were running twenty-four hours a day. Businesses were borrowing money as fast as they could in order to produce and sell more. A budget deficit would be likely to require creating more money. The result would be more inflation. And prices during 1966 had already risen 3.3 percent.

But the President did not ask Congress for a tax increase. Advisers told him a tax increase proposal would be defeated overwhelmingly in Congress. He also felt a tax increase would focus attention on the reason for the increase—a war in Asia that was becoming unpopular.

After nineteen months of inaction, the President finally asked for a tax increase in August 1967. He maintained that the increase was needed to prevent a budget deficit posing "a clear and present danger to America's security and economic health." Even with a tax increase there would be a budget deficit. Without it the deficit would be huge.

Even though a majority of Congress were Democrats, as was President Johnson, Congress was in no hurry to increase taxes during an election year. It took ten months to pass the bill. The surprise was that Congress passed the bill in the face of a public opinion poll showing that 80 percent of the American people opposed a tax increase. Congress refused to increase taxes unless President Johnson would agree to reduce government spending, a proposition which he eventually agreed to accept in order to obtain the tax increase.

In June 1968, Congress passed and the President signed a bill increasing taxes for millions of taxpayers. The same bill required a spending decrease of $6 billion. The President then stated he would cut $3 billion from the defense budget (but excluding outlays planned for the Vietnam War) and the rest from elsewhere in the budget. One of the reasons he objected to the mandatory cut in expenditures was that he felt most of the remaining cut of $3 billion would be in social and welfare programs, which would chiefly affect programs to alleviate poverty.